"Magma Fincorp Limited Q2 FY16 Earnings Conference Call"

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MODERATOR: **MR. KUNAL SHAH – EDELWEISS**

Moderator: Ladies and gentlemen good day and welcome to the Magma Fincorp Limited Q2 FY16Earnings Conference Call hosted by Edelweiss Securities Limited. As a remainder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kunal Shah of Edelweiss, thank you and over to you sir.

Kunal Shah: Good morning everyone. This is Kunal Shah from Edelweiss, we have with us Mr. Sanjay Chamria – Vice Chairman & Managing Director, Mr. Atul Bansal – Chief Financial Officer and Mr. Kailash Baheti – Chief Strategy Officer of Magma Fincorp to discuss their second-quarter earnings, so over to you sir.

Sanjay Chamria: Good morning everyone, this is Sanjay Chamria I welcome you all to the second-quarter earnings call of Magma and thank you for taking time to join the call.

The overall economic activities is yet to show signs of pickup despite numerous efforts and announcements by the government and the inadequate monsoon during the last season has not helped the cause of rural demand revival. However, there are some pockets of demand growth particularly in the medium and heavy commercial vehicles with fleet replacements by the large operators and passenger vehicles. While the sale of tractors and the construction equipment have continued to slow down. In my view maintained steadfastly we will have to wait till March or April 2016 for the economy to rebound as the government unleashes various programs in the infra sector which will push up the demand for core sector and eventually it will have a domino effect.

The pleasant surprise towards the end of the quarter came from RBI when it announced rate cut of 50 bps and signaled benign inflation for the coming year and also nudged banks to pass on the benefit of rate cuts to their clients. Therefore we are hopeful that during Q3 and Q4 of the current fiscal year we should benefit from the base rate cut announced by many banks and it should improve their spreads on one hand and spur the demand on the other. With the NBFC sector to cater to the under bank and underserved customers in the rural and semi-rural India would await crop output and the government push on the economic reforms to support the loan book growth and improvement in the NPA trends as the customers we cater are largely dependent on deployment of the financed assets like tractors, trucks, taxis and equipment to pay the instalments after meeting their domestic expenses.

At Magnum we have adopted a cautious approach since Q4 of last year apprehending slowdown and delayed recovery and used it as an opportunity and we continue to focus internally on creating a long term sustainable franchise. Our focus areas have been on restructuring the product basket resulting in optimum risk return, through alignment of products, customers, geographic mix and investment in newest technologies tools to drive productivity improvement and customer satisfaction. Over the last few quarters we have

successfully experimented with several such initiatives which have already started bearing fruits and it can be seen in the form of reduction in OPEX ratio and the improvement in the NIMs the two large areas impacting our performance.

One of the successful experiments conducted by us allows our field executives to use their interaction with the customer and repayment pattern has credit evaluation surrogates lifestyle data when there are limited of unreliable data points. A majority of our collections happen in the cash through physical meeting with our customers and our field executives are now enabled with tablets to record their lifestyle data about the customers that is being fed into a data warehouse and is used to prepare the scoring algorithm that allows us to make real-time pricing offers to our customers. This enables us to provide financing for assets required by the customers that's when he wants to acquire a larger house to accommodate a bigger family or wants to upgrade from a scooter to a car. It will also be very useful in covering cross sell opportunities especially in insurance and mortgage businesses.

We aim to enhance our customer connect by making it extremely simple and quick for an existing creditworthy customer to take a repeat loan from us. With the changing telecom and the media landscape even in the rural India we continue to pioneer the use of technology to drive distribution. Effectiveness of our large field force through cross sale and to provide best in class customer service. In fact FY16 has been a year of benefiting from the significant investments in our front end and back end to drive a superior end to end loan process. We are concentrating to reap the benefits of this launch in the company over the next few quarters.

On the product development front I would like to use our SME loans business as an example to demonstrate how we are driving process and product innovations within the company. A small team was tasked in December 2014 and they did an exhaustive analysis of the customer and the channel needs, identify existing markets gaps and then created solutions that can fill these gaps. The implementation of this project has resulted in 60% YOY disbursal growth. Moreover we have mined our 7+ years of SME customer data and having studied nearly 3 business cycles we have identified the optimum mix of average ticket size and the tenure of loans across geographical clusters and various industries. This has resulted in disbursal that are showing lower delinquency. Finally this project has focused primarily on the indirect sales channels in the 40 odd locations where we are present and the next priority will be to expand this business to 100+ locations leveraging the existing workforce and the customer base for cross sell.

We are also in talks with several digital companies to expand our customer acquisition channels. I am confident that various changes we are implementing across the organization similar to what we have done in the SME loans will add up and help us emerge as one of the most innovative financers in the fast evolving finance industry.

I would now like to share with you the key highlights of our performance for Q2 and its impact on our results. Our focus will continue to be on profitable growth through execution excellence and not deviate from the strategic direction set at the beginning of the year. The results of this focused execution will drive results measured by improvements in OPEX ratios, NIMs

expansion and overall ROA improvement. We have continued to improve the share of the used assets, tractors, SME and mortgage in our product portfolio and their share has now increased to 55% of the total loan book while disbursal during the quarter in these assets have contributed 66% of our total disbursals. While the disbursals have grown 6% on QOQ basis, the loan book is largely flat at 18,812 crores compared to last year due to our focus on building profitable loan book. As a result the NIMs have improved handsomely from 5.87% in Q2 of last year to 6.83% in Q2 of this year. As I had also mentioned in our last quarter call we are on track to achieve NIMs of 7% over the next few quarters. The series of measures undertaken to improve the OPEX ratio has started bearing results from Q1 of this year, our OPEX ratios have dropped to 3.41% during the first half this year compared to 3.66% in FY 15. It is particularly significant to note that it has happened despite flat loan book and once the book starts growing the impact on OPEX ratios will be lot more pronounced and positive. Our focus on OPEX reduction will get huge fillip with our focus on growing the share of direct business thereby reducing channel cost and driving cross sell opportunities and owning larger share of the customers wallet over his lifetime. We would like to stick to our customer centric approach and superior customer service and retention over a longer period, our two key pillars for the OPEX reductions strategy. We have started to see the positive signs of this and we have achieved 18% of our fresh business in mortgage during the first half of the year by way of cross sell to our existing vehicle finance customers which are largely in the rural areas and the ticket size is around 15 to 17 lakhs. The collection efforts are being hampered due to prevailing tough market scenario, the lower deployment of the vehicles and the equipment by our existing customers and the lower crop realizations owing to poor monsoon and crop damages has impacted the inability of customers to honor their commitments and it has resulted in higher delinquency and NPAs. However, with the tightening of credit schemes and the processes and the reduction of new business in certain products, customers and geography the quality of the new portfolio origination is quite stable. The Rabi crop is now ready for harvesting and we should benefit from the same flowing to the farmers in this quarter. This should give an impetus to the rollback of the tractor loans; in addition the credit cost should reduce faster if the economic situation shows signs of improvement. Our credit cost has increased during the quarter by 26 crores to Rs. 89 crores and on the 120 days DPD recognition basis the G&PA has increased from 5.87% in Q1 to 6.85% and the NNPA from 4.69% to 5.46%. We are compliant with the RBI guidelines on the NPA provisioning right up to March 2017.

As a result of all the above activities our profit before tax has increased by 52% from 48 crores Rs. 73 crores, while due to the higher tax outgo the PAT has increased by 15% from Rs. 42 crores to Rs. 49 crores. As I have reiterated multiple times our focus during FY16 continues to be on profitable growth improving the operating effectiveness through more direct business sourcing from the existing customers, reduction in OPEX through faster adoption and implementation of technology led process simplification and superior portfolio origination through product customer and geography mix. All these should result in higher NIMs, lower OPEX and improved profitability.

The capital infusion of Rs. 500 crores done in May provides us enough headroom to drive growth post 2016 fiscal year as and when the market revives.

So myself and Atul and Kailash would now be happy to take any questions that you all may have. Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin their question and answer session. Our first question is from the line of Abhishek Kothari of Anand Rathi. Please go ahead.

Abhishek Kothari: Could I have the slippages during the quarter and a sectoral breakup of how the slippages look liked in the quarter?

Sanjay Chamria: I think sectoral wise these slippages has been maximum in the tractors followed by the passenger vehicles. So far as the SME and used assets are concerned they are practically flat. There is some slippage in the mortgage and the new CV & CE where we have cut down on the exposure it has improved rather but then portfolio weightage has gone down.

Abhishek Kothari: Absolute figure of slippages?

Sanjay Chamria: I think that is something which can be given off-line by Ujwal to you. Because I do not have it right now with me.

Abhishek Kothari: Any securitization done during the quarter?

Sanjay Chamria: We continue to pursue securitization as a mode of our **(Inaudible-14.10)** so we continue to do and during the quarter also we have done about Rs. 600 odd crores of securitization. We have stated our policy that total loan book one third of our loan book and the large part of it we do as a direct assignment and the smaller part we do as through the PTC route and we continue to follow the same.

Abhishek Kothari: Despite pain seen in used assets our sequential disbursement have fairly remained strong so how do you see the road ahead in terms of used assets financing and where can we see the NPA levels shooting up from here to let us say by March end?

Sanjay Chamria: In the used assets in fact we have not grown, we are rather marginally de-grown in terms of the disbursal but the NPA trends as I said have been pretty encouraging in the used assets apart from the **SUVs 15.23** and these two are part of our four products will want to know that weightage. So the four products where we want to grow our weightage is used assets, SME, tractors and housing. So out of these four products the two products which have remained pretty robust in terms of asset quality are the SME and the used assets and we have reoriented our credit streams and the processes looking at the risk involved in the current market and therefore we have cut back on the disbursals but the asset quality has improved significantly, so even by March 2016 I would rather expect some improvement in the used assets credit quality.

Abhishek Kothari: You can give me sectoral breakup of your gross NPA?

Sanjay Chamria: This is what I was saying that maybe off-line can be provided. I do not have it right now.

Moderator: Thank you. Our next question is from the line of Deepak Poddar of Sapphire Capital. Please go ahead.

Deepak Poddar: Currently in terms of our business composition I think new business is about 55% and old businesses are about 45% so what kind of this composition mix do you expect over the next two years?

Sanjay Chamria: We have stated in fact over the last few quarters that in order to improve the risk return mix we want to grow the weightage of these four products and now there are 55% but in terms of disbursal and they are 66% and by FY18 I would expect that the share of mortgage, SME, tractor and the used assets would be close to 70%.

Deepak Poddar: By FY18?

Sanjay Chamria: By FY18 that is in the next 2.5 years. So gradually it will keep increasing and we should also improve our NIMs to take it far beyond 7%.

Deepak Poddar: But in terms of ROA what would be the current mix in terms of legacy businesses versus the new business, composite ROA is I think close to about 1.3% but individual ROA would help actually?

Sanjay Chamria: Obviously these four products have ROAs which are a lot higher so SME and used and tractor they give us the ROAs which are far in excess of 2.5% and which is the reason we want to grow the contribution of these three and mortgage again is a more longer term game and there also the ROAs are in the range of 1.75% to 2% whereas the ROA in the new car, new CV and the new CE are lower, and I had explained this in the last quarter call that in the best of the times also the spreads are never more than 4% and the credit losses are never less than 1% so therefore net of the OPEX the ROAs are around 1% and therefore we have decided to cut down on the exposures in the new car, new CV and the new CE and grow on the other four products so therefore the overall ROAs can go beyond 1.75%-1.80%.

Deepak Poddar: By when?

Sanjay Chamria: This we are looking to do over the course of next two years so last year and a year before our ROAs were about 1% and now they have stabilized at 1.25%, right now while we have improved on the NIMs front significantly we had given a guidance at the beginning of the year that this year we propose to reach 6.5% but by the end of Q2 we are already at 6.8% so even if its moderates down with the benefit of the cost reduction being passed on to the consumers still I would expect it to be substantially higher than 6 .5%. With the further changes happening where the contribution of these four products are expected to further go up I would expect that NIMs will cross 7% in the next few quarters. Similarly our OPEX has been going down but it is the credit cost which has actually mitigated some of the improvements that we brought about and therefore the profit before tax or profit after tax has not grown as much as it should have.

Therefore with the credit scenario improving which we all expect that should improve from at least April 2016 I think we should see a significant improvement in the ROA.

Deepak Poddar: In terms of credit cost we had earlier said that maybe the pain in our credit cost might last for another one or two quarters, so currently I think we are about 2.6% credit cost on our loan book so has it peaked out of there is further pain that we can expect on the credit cost outlook?

Sanjay Chamria: See what I said that this year the credit cost is expected to be a bit higher compared to last year if you reflect on my last quarters call because the new portfolio that we have started writing from February 2015 and I had shared it that we have reoriented our product customer and geography mix and therefore we decided to take a cut back in the disbursal because our focus is completely on building a profitable loan book and if it that impacts us in terms of growth so be it. So therefore the new loan book by March 2016 will be almost about 45-50% of the total loan book. So the benefit of that in terms of the credit cost should get reflected in FY 17 to a certain extent and more fully in FY 18. Of course it was predicated on the assumption that the scenario in the market will not deteriorate if not improve further.

Deepak Poddar: But like over the medium term if I take 3 to 4 years what is the credit cost that we would ideally be happy with the kind of number because earlier I think we had shared that about 1.25% is what number we might be happy over the next three years. So is that the long-term trend that one should expect or because of these changes may be we might start falling from 120 days to 90 days in due course of time, so what would be the new credit cost? Some sense on that would be helpful.

Sanjay Chamria: In the last 2-3 years the credit cost has significantly shot up and before that the cost was less than 1% and there are two developments which have happened in the last 2-3 years and is expected to continue in the next two years. One is that the norms of NPA recognition having changed from 180 to 90 days so that obviously will increase the credit cost for all the players and while we are compliant in March 2017 in terms of 120 DPD now but in March 2018 be will need to take an additional hit and which could be about another 30-35 bps on account of migration from 120 to 90 DPD. And the second change which has happened and more particularly for Magma is the change in the product focus from new car, new CV and CE to the tractor, used and SME where in the credit costs are expected to be higher given other factors being same and therefore you are right I had said that it should be in the range of 1% to 1.25% and however in FY 18 with the migration to 90 DPD it could have another impact of about 25-30 bps.

Deepak Poddar: May be a new normal might be close to about 1.25 to 1.5%.

Sanjay Chamria: Yes I would think so.

Deepak Poddar: When you would start migrating maybe some 5-5 days or some other kind from 120 days to 90 days? Do you have any plans that when you start migrating?

Sanjay Chamria: Unlike my peers who were either it 180 or 150 and therefore they started gradually moving 15 days or 30 days we already had been following 120 days and therefore we don't need to make any staggered change or an impact in our P&L provision. So we would migrate straight to 90 days from 120 days starting FY 18 because that is where it is applicable and usually it is applicable by last quarter but we will take a decision at that point of time whether we want to follow it from first-quarter or second-quarter or do a staggered or do straightaway one-shot by March 18 in the quarter 4.

Moderator: Thank you. Our next question is from the line of Prakhar Agarwal of Edelweiss Securities. Please go ahead.

Prakhar Agarwal: During this quarter we have seen a tax rate rise can you throw some light on why it has risen to 31% odd?

Sanjay Chamria: The increase in the tax rate is function of the lower securitization income during the quarter. So while the amount of business that we have securitized is pretty much the same as I answered to one of the first questions that this is in line with our strategy of about one third of our book being financed through the sell down route which gives us the benefit of lower funding cost as well as also absorption of the credit cost in the **DA deals 25.18** by the investor, the earnings during the Q2 has been lower on account of the lower collection efficiency as because there is a concept of the EIS which is on cash basis so therefore if the collection is lower and even if the account is standard that is below 120 DPD still you need to take a hit in your books and the income is lower then that income is exempt from tax and therefore you have an effective lower tax rate. Due to that reason our tax rate and tax provisions during the quarter is higher compared to the earlier quarters.

Prakhar Agarwal: What was the securitization income during this quarter?

Sanjay Chamria: Just about Rs. 3 crores.

Prakhar Agarwal: And which was comparable last quarter was?

Sanjay Chamria: Last year it was Rs. 27 crores in the second quarter last year. So from Rs. 27 crores it is down to Rs. 3 crores.

Prakhar Agarwal: In terms of other subsidiaries what we have seen the performance had been a bit lackluster specifically in terms of you general insurance. So what is your outlook on that? And some sense on PAT performance of your other subsidiaries?

Sanjay Chamria: We have three subsidiary companies and one is this insurance and the other is housing and the third tractor JV. The performance of the insurance and the tractor JV company has not been good during the quarter, tractor JV is largely on account of the higher provisioning as I was sharing that tractor has been the worst impacted because of the third successive crop failure in majority. In the major agriculture states which is MP, Maharashtra and Haryana and parts of Western UP and therefore there is a higher provisioning which is reflected as I said that the

good effects of the higher margins and the lower OPEX has been nullified to an extent by the higher credit cost and tractor has had the highest credit cost so therefore in the tractor JV which is single product company it has been significantly impacted. So far as the insurance is concerned there the impact has come on account of a higher provisioning during the quarter of the third party motor liability which actually went up by about 1.7%. And so far as the housing subsidiary is concerned that I think has done pretty alright and the business has grown, the profits have grown. They were just about a couple of accounts which were large ticket size in the lap which due to temporary cash shortage gone up and therefore we had to make a provisioning. Although despite the higher provisioning also it has reported a good in the profits. We are in touch with those 3 - 4 large accounts and over the next few quarters as they rollback I think that should release the provisions. This is how I will put out the performance of the three subsidiary companies.

Moderator: Thank you. Next question is from the line of Umang Shah of Emkay Global. Please go ahead.

Umang Shah: As you mentioned in your opening comments our NPLs currently are at 6.85% on gross basis on 120 days past due basis and 5.46% is the net number, is that right?

Sanjay Chamria: Yes that is right.

Umang Shah: You mentioned that the migration from 120 to 90 will happen only at the beginning of FY 18 so for the remainder of this year and next year we will be complying at 120 only, right?

Sanjay Chamria: Yes.

Umang Shah: The ROA guidance that you mentioned that over the next two years you see ROAs moving from 1.31-1.3% levels to 1.7-1.8%, I just wanted to understand that despite you being fairly confident of margins moving up to 7% plus levels and OPEX coming off and obviously the underlying assumption being that the credit cost which are elevated at this point in time and even credit cost falling in line, just wanted to check that a 1.7-1.8% guidance is it a bit more on the conservative side and is there any scope for you to outperform your own guidance?

Sanjay Chamria: I will make two observations to your long comment, one is that regarding the migration to 90 plus I think regulator itself has allowed 120 days past due till March 2017 and is we are one of the very few companies which are already compliant right up to FY 17, so therefore if we take a decision of migrating to (+90) in the first quarter or whichever quarter of FY 18 then I think we would be one of the early adopters of the RBI policy. So I am not sure as to what was the rationale behind the comment but I think rather we as a company that far ahead in terms of the adoption of the RBI provisioning policy. The second observation that you made on the ROA, as a company we have in the last 2-3 years suffered from a lower ROA and therefore in various analysts calls I have explained that there are three things that we need to do in order to improve the ROA one was to improve our NIMs second was to reduce the OPEX ratio and third was to contain the credit cost and the ROA is the result of these three steps and initiatives. If you see over the last 6 quarters, 5 quarters we have consistently improved our margins so from a level

of lower than 5% in FY 14 now we are at 6.83% in FY 16 second quarter whereas I had in the beginning of the year given a guidance of 6.5%. So even if there are some blips here and there I expect it still to be far higher than 6.5% by the time we end the year and therefore with the continuing thrust on the four high margin and high ROA product we expect that the 7-7.5% is the range that we will look for in the next 2-2.5 years, that is so far as the margin expansion is concerned. Second we are the highest OPEX in the industry at 3.65% in FY 15 which I had shared in the last year's results that we have taken steps and this year we propose to keep it at about 3.35% so there is a 10% reduction in the OPEX that we are looking to achieve despite flat loan book and if you see also our six-month results we are now at 3.4% as against 3.65% for the last whole year and wherein the loan book is flat at about close to Rs. 19,000 crores. So in absolute amounts our OPEX has gone down. So as the credit scenario improves and there is a demand pickup that happens in the economy we have already made all the investments be it in the people or the technology or the process so therefore then it is the payback time in terms of growing the denominator and then the OPEX should further go down. That is the second one. So far as the credit cost is concerned this I have shared last year when our credit cost our OPEX went up to 3.65% that we had to make significant investment in the collection initiatives various projects that we implemented and that I did mention that we have now implemented all the projects. However the performance of collection and therefore the credit cost is largely dependent also on the external environment. Now unfortunately the external environment in our country has not been very congenial from our business point of view. Apart from the government related reforms and the push on the infra and other things that we expect them to do even the nature Gods have not been very kind. And if you look at this year while the LPA deficiency in the rainfall is 14% but there are states which have a major deficiency of 30-40% and these are unfortunately major agriculture producing states in the country. Therefore we are taking a hit in terms of credit cost which is more than what has been budgeted. Obviously you don't expect that will last forever. So therefore we hope that over a longer period and this is what I said that we are looking at in terms of tractor, and the other rural vehicles the lifetime profitability and we still remain bullish that so far as the tractors, used assets are concerned that lifetime profitability will remain in excess of 2.5% post tax ROA and therefore we wish to continue to maintain higher weightage on that. So this is my answer to your second observation.

Umang Shah: First, on the NPL one just to clarify I was just verifying the data points. Second, in fact I completely agree with your explanation and that exactly drove me to the point that is there scope for you to actually deliver better than 1.7-1.8 assuming that if things were to work in your favor, credit environment as well as asset quality environment was to improve then is it a fair enough assumption to make that you guys can actually over deliver what you are promising today?

Sanjay Chamria: Obviously everybody as a private enterprise which I know would thrive on the higher profitability would want to achieve that but it is very difficult to gaze into the future and then say. So I am not assuming that there can be a dramatic improvement in the economy. So even if there is moderate improvement we are confident that what we are talking we will be able to

achieve but if there is a like what we have seen in the earlier times 2010 to 2012 if that kind of scenario comes in obviously we will do much better but you do not know about that.

Umang Shah: Regarding the OPEX ratio what you mentioned, so where do you think is the level beyond which the OPEX ratios cannot fall so let us say a 3% or 3.2% or do you think is there any particular level wherein beyond which it cannot fall?

Sanjay Chamria: The industry median if I look at is at about 2.8%, you have players ranging from 2% to 4.5% and we feel that given the products suite that we have and the average ticket size we have more juice to be extracted out of this but we do not want to destabilize the way things are going so therefore the first step was in this year and which in my view is the most difficult year because if your loan book is flat, credit environment is tough you need to make more investments in collecting from the delinquent customers wherein if you are able to reduce your OPEX by 10% and as I also mentioned in my opening comments that we have done certain experiments and we have got good results and we are looking to launch and over the next few quarters so therefore once you have done it more successfully we will come back but my ideal world scenario would be to bring it below 3% over the next two years.

Moderator: Thank you. Our next question is from the line of Aadesh Mehta of Ambit Capital. Please go ahead.

Aadesh Mehta: You mentioned that there were certain delinquencies in our loan against property book in terms of certain high value borrowers, can you elaborate a bit on the ticket sizes and the existing LTVs we have on these kinds of borrowers?

Sanjay Chamria: We started the mortgage both the LAP and the home loan from June 2013 and initially we took certain exposures which were high ticket size, which is more than 1 crore while our average ticket size until March 2015 was about 27-28 lakhs, but then there were certain transactions which were more than Rs. 1 crore and while the LTVs were about 50-55% which is fairly conservative however there are cash flow issues with those self-employed businessman and therefore that is what I mentioned that these accounts due to temporary cash shortage have gone into NPA. However, over the next few quarters because our management team is in touch with those borrowers the properties are there, the customers are there and there is no legal hassle in the title so they should rollback. However from November 2014 we have actually taken a policy and our average ticket size now has fallen in the month of October for example last month to 17 lakhs and even within LAP it has fallen to about 21 lakhs for 22 lakhs and we are not taking any exposure which is beyond Rs. 1 crore because we find that the larger ticket size there are more cash flow issues whereas the smaller ticket size it is more comfortable and when we do our portfolio cuts also we find that in the smaller ticket size the performance is superior to the higher ticket size.

Aadesh Mehta: What is your experience in LAP between loans collateralized against commercial property and loans collateralized against residential property? What we have been hearing is that intuitively the asset quality against the loans collateralized by residential property should be better

compared to those collateralized by commercial properties but then with the commercial property doing good are we seeing that residential property asset quality could deteriorate faster than those of commercial property?

Sanjay Chamria: In our limited experience thus far we have also seen the same thing that the self-occupied residential properties tend to perform better in terms of the home loans as well as in terms of the LAP compared to the commercial properties because the emotional and the sentimental attachment of the borrower is a lot higher in respect of self-occupied residential property.

Aadesh Mehta: But are we seeing that asset quality could be improving in the LAP for commercial properties given the commercial properties are doing good now or doing better than the residential properties?

Sanjay Chamria: The performance of the commercial property improves so I am not commenting whether I agree with your assessment in that commercial properties are doing better now but if that starts improving then obviously the performance of the portfolio collateralized by the commercial property would definitely improve, but I personally do not share this optimism at least at the present moment.

Moderator: Thank you. Our next question is from the line of Rishendra Goswami of Locus. Please go ahead.

Rishendra Goswami: You commented about 18% mortgage disbursal in H1 went to your existing CV customers, is that right?

Sanjay Chamria: 18% has gone to our existing customers, this could be a CV, tractor, SME and all products.

Rishendra Goswami: Were this all direct company disbursals or it was cross sell through some other channel as well?

Sanjay Chamria: No it is all direct there is no channel involvement in this 18% business.

Rishendra Goswami: In terms of the credit assessment because you are already lending to an existing borrower what kind of additional collateral or assessment do you follow in that case?

Sanjay Chamria: To our existing customers we have the primary collateral of tractor or a commercial vehicle or a construction equipment or a passenger vehicle so when we are doing a housing loan then the collateral there is different which is immovable property.

Rishendra Goswami: The way that credit things on these exposures is what? Is it based on income ability of the customer or just it is a plain collateralized loan?

Sanjay Chamria: If you look at the collateral value and the LTVs that we have on an average is about 55% whereas in some properties we can go higher up to 75% also. But we do look at the cash flow ability of the customer to pay the instalment so it is not that somebody who does not have a

demonstrated cash flow and has a good property and still we can give a loan, eventually he will repay the instalments from the cash flows and not by selling the property.

Rishendra Goswami: I assume these are all current loans, no NPA type customer here?

Sanjay Chamria: The performance of this cross sell to our existing customers we have found this superior to the overall loan book that is being created. So it also demonstrates that the existing customers who have a good track record and have been found to be eligible for a repeat mortgage loan by us, they tend to perform better compared to the first end customers being acquired in mortgage.

Rishendra Goswami: What percentage of your current mortgage book would be in 1+ crore ticket?

Sanjay Chamria: I would not know this number right away; I think it would just take me sometime. It can be provided offline by Ujwal.

Rishendra Goswami: One last question on the coverage, if I look at the NPA numbers the coverage seems to be around 20-25% somewhere there, so what kind of coverage of the comfortable with over the next couple of years or so and how does that change the overall credit cost for the company?

Sanjay Chamria: There are two reasons for the lower coverage, because this coverage definitely is lower and there are two reasons for it, one our NPAs are of a recent origin because earlier we used to write off before we migrated to the policy of 120 days recognition for the NPA. At that time we used to do securitization and recognize income upfront so we started amortizing the income and we also started recognizing NPAs. So that happened from the last 2.5 years. And therefore in the early stages of NPA the provisioning coverage would be lower, as you grow older the provisioning coverage will improve that is reason number one. Reason number two is that in respect of the securitized book like in the earlier question I said that the EIS hits that we take that is not reflected in the provisioning but that also is equivalent of provisioning. So if you add up that amount then this will grow by another 4-5 percentage points. So the overall coverage would be about 25-26% as against 21% which is reported.

Rishendra Goswami: You want to maintain this 25-26% coverage going forward or you want to increase it to a higher level from here?

Sanjay Chamria: Obviously as I said with the passage of time so as it moves into the higher bucket then the provisioning rate increases. And two, in respect of the unsecured loans we have a tightened norms and there we do a complete 100% provisioning. And even in respect of the secured assets where the value of the asset is lower than the principal outstanding then the uncovered portion there is a 100% coverage that we provide. So with the lapse of time even in respect of the existing accounts where the value of the collateral falls below the principal outstanding the coverage is 100% and in respect of the unsecured SME loan beyond a certain period of time it is 100% whereas in case of a secured loan it starts with 10% and then after it crosses the next higher bucket then it goes to 25% and that is how the provisioning is being done.

Rishendra Goswami: As these NPAs age and if the collection efficiency remains low then the provisioning number will remain high around 2% or so now, so that is difficult to come down unless the collections improve significantly?

Sanjay Chamria: Absolutely.

Moderator: Thank you. Our next question is from the line of Sunil Kothari of Unique Investment Consultancy. Please go ahead.

Sunil Kothari: Just wanted to understand as a layman investor that this 7-7.5% NIM in this type of scenario more private banks, more small banks everybody's focused on SME, retail and all these things, how it is feasible and how you want to achieve just broadly you can tell?

Sanjay Chamria: The segment of the customers that we are dealing with, one as you have heard during course of the call that the OPEX ratios at a median level is about 2.8% and if you remove the extremes the outliers then the OPEX ratio itself is about 3%. Second is the credit costs also as you heard is expected to be about 1.25% and with the higher provisioning starting from FY 18 this could impact another 25 bps so it could be in the range of 1.25-1.50%, so if you adjust these two then you are actually left with pre-tax ROA of about 2.75% which on a post-tax will give you a 2%. So whether it is a small bank or it is a NBFC or it is any other player today I think the market expectation is that one needs to earn the ROA in the range of 1.75 to 2% to provide on ROA growth which is sustainable in the long term. The second I would also believe that from a banking player standpoint they have larger level of supervisory oversight, regulatory oversight and on the deposits that they accept there is also a drag in the form of the CRR and SLR and various other compliances that they need to do. So while the cost of deposits that they will have will be lower than the cost at which we borrow money from the market but on the other hand they also have a higher compliance cost.

Sunil Kothari: So there is no major threat to this rate of interest?

Sanjay Chamria: I would not see major threat from these small or a payment banks, I would rather see the threat from the existing bankers which have also been operative in the similar customer segment that we are operating in and they already have a significant branding, significant deposit franchise and to compete with them, so to me they are larger threat and therefore it requires that we need to be a lot more efficient in the coming years therefore we remain relevant in the market that we operate.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the floor back to Mr. Kunal Shah for closing comments.

Kunal Shah: Thank you everyone for participating in the call and thank you everyone from the management for sharing their insight. All the best for the future quarters.

Sanjay Chamria: Thank you.

Moderator: Thank you. Ladies and gentlemen on behalf of Edelweiss Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines.