# "Magma Fincorp Q2 FY18 Earnings Conference Call"

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**MODERATOR:** **MR. PRADEEP AGARWAL – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Magma Fincorp Q2 FY18 Earnings Conference Call, hosted by PhillipCapital (India) Private Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. I would now like to hand the conference over to Mr. Pradeep Agarwal from PhilipCapital India Private Limited. Thank you and over to you, sir.

**Pradeep Agarwal:** Thank you, Stanford. Good morning, everyone. And welcome to the Quarter Two FY18 Earnings Call for Magma Fincorp. To discuss the results, we have with us Mr. Sanjay Chamria – Vice Chairman and Managing Director, Mr. Kailash Baheti – Chief Financial Officer, Mr. Kaushik Banerjee – President, CEO, ABS Business; Mr. Manish Jaiswal – Managing Director and CEO, Magma Housing Finance; and Mr. Rajive Kumaraswami – Managing Director and CEO, Insurance.

I would now like to hand over the call to Mr. Chamria for his opening remarks. Over to you, sir.

**Sanjay Chamria:** Thank you, Pradeep. Good morning and welcome you all to the Magma second quarter investor call. First, I would like to share my views on the economy. The demonetization and the GST lead disruption has slowed down India's GDP growth in the first half of this year with the growth dropping to 5.7% YoY in Q1. With the implementation of GST, India has entered into the new phase in indirect taxation. However, in the near-term some transitional disruption is visible in the unorganized MSME sector as the government strives to resolve various structural and technical glitches in the implementation of GST.

On the other hand, the government has released all the NREGA backlog wages, and most of it through the mechanism of direct credit to the wage earners, putting money in the hands of population in rural India. The government has also made big allocation to the Prime Minister Awas Yajna, popularly known as PMAY and Credit Linked Subsidiary Scheme which is CLSS scheme to push affordable housing. Further, the government is focused on infra spending to improve economic growthand has announced, big ticket mega projects like Bharat Mala and Sagar Mala. These initiatives are big positive for rural income and rural demand.

We expect the economy to pickup from second half of FY18 on the back of rural demand, which apart from the push in the government initiative, as I just mentioned, will also be driven by near normal monsoon, improvement in the Kharif crop acreage and hike in the MSP.

With our wide range of product offering of vehicle finance, affordable home loans, SME and general insurance, with each business being helped in great measure by the structural changes undertaken by us over the past 18 months and the entire leadership team with a proven track record now operating from our office in Mumbai, we are confident to leverage on all the emerging opportunities.

Let me now give overview on our business and performance for the Q2. First, the asset quality. We are completely focused on our motto of "portfolio first" at organizational level, and this is resulting in consistent improvement in the asset quality. First half typically is a lean period for the finance industry, however during the first half of the year our absolute GNP has remained flat, and the absolute NNPA has reduced by 6%. We expect this trend of reduction in the NPA numbers to accelerate in the second half.

Moving to disbursals ,The AUMs, our vehicle finance disbursals grew by 11% on sequential basis. We continue to work on de-risking our portfolio concentration which is evident from a strong growth of 25% QoQ and 27% YoY in the used asset and over 100% QoQ and 140% YoY for commercial vehicle. Whereas the tractor disbursals have de-grown during the period.

As I shared in one of our earlier interactions that for vehicle finance business we graded all our branches in A to D with category A and B having superior portfolio quality. Our disbursals from these branches, A and B have been 61% in first half of the year against 28% in the first half of last year.

This realignment and de-risking of the portfolio has resulted in marginal de-growth in the AUM by 1.4% on a QoQ basis. While we remain committed to our moto of "Portfolio first", we expect our vehicle finance AUM to start growing QoQ from this quarter onwards.

In Mortgage business our focus is to incrementally grow the affordable home loan book, leveraging large opportunity driven by PMAY and CLSS on the back of Magma'sstrength in the rural and semi-urban India through 300 plus branch network. We grew our affordable home loan disbursals by 26% QoQ while the disbursals of LAP remained flat. We also improved our direct sourcing from 26% in the first quarter to 32% in the current quarter, building on our go-to-market strategy. Our average ticket size remains granular at Rs. 13 lakhs andnd of this, 88% of our disbursements is below the ticket size of Rs. 25 lakhs, and no disbursal over Rs. 50 lakhs.

Hiring of top leadership for the housing business is now complete, and we have grown our feet on the street by about 30% in the last six months. We expect the disbursal in mortgages to achieve healthy growth month-on-month from here on.

In our SME business, we are reasonably happy with the sustained performance even on the back of two major short-term disruptions, which is demonetization and GST. SME business grew its disbursals by 20% on QoQ basis and continued its trajectory of profitability and credit quality. As a conscious strategy, we plan to expand our SME business, which presently has presence in top cities to the Tier-III and Tier-IV locations and expect to continue its growth trajectory on the back of this expansion. GST is expected to be big credit enabler in our SME business with the strength of existing Magma branch network. We are quite confident to seize this opportunity.

Our insurance business continues to register healthy growth rates in the current fiscal, in line with the market growth rates. The business has grown by 29% YoY in Q2 and 28% in first half. In the motor line of business, which has been our strength, our loss ratios are now among the lowest in the general insurance in India. With a view to reduce our dependence on motor, we continue to grow our non-motor book, which now stands at 25% vis-à-vis 20% last fiscal. Furthermore, we have received regulatory approval for our retail indemnity health product and which shall be introduced in the third quarter. This would provide further diversification in our products bouquet. Magma HDI's registered profit in FY17 and continues to remain profitable in the current fiscal year. All in all, we are fairly optimistic of sustained profitable growth for our general insurance business.

Now I would like to share the key highlights of our financial performance for the second quarter. In the Q2, we reported a healthy NIM of 8.4%, which is 100 bps higher than second quarter last year. The expansion in the margin was largely due to the improvement in cost of funds and increase in the share of earning book. We expect our NIMs to stabilize at the current levels as we intend to pass on the further benefit of rate reduction and improvement in the portfolio quality to the customers.

Our cost to AUM ratio marginally increased to 4.4% in the second quarter, largely due to the lower loan book and increase in the management bandwidth. However, the benefit of operating leverage should be visible with the revival in AUM growth.

We had a total provisioning of Rs. 75 crores in the second quarter against Rs. 91 crores in the first quarter. We have made additional provisioning of about Rs. 8 crores, considering migration to 90 DPD in FY18. Consequently, our coverage ratio improved to 24% against 20% in the first quarter.

Our PAT at Rs. 49 crores is marginally lower than last year. Our ROAs for the quarter has improved 15 basis points YoY, and QoQ to about 1.5% on the back of better operating performance. We expect this trajectory of ROA expansion to continue in the coming quarters.

Kailash, Kaushik, Manish, Rajive and myself will be happy to take any questions that you all may have. Thank you.

**Moderator:** Thank you very much, sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. We take the next question from the line of Chandana Jha from Principal Mutual Fund. Please go ahead.

**Chandana Jha:** I have three questions. My first question is on your CV portfolio. Could you share, we have seen significant growth in disbursement in CVs this quarter, of course, on a low base. If you could share which segment in CVs we have grown, and what is the incremental yield in each of these sub-segments? That is my first question.

My second question is on margins, we are at 8.85%, and we have guided these stabilizing at current levels. What in your assessment could be the impact of margins if interest rate cycle reverses? If you could give your view on this, it will be helpful.

**Kaushik Banerjee:** Chandana, this is Kaushik. So to your question in terms of the breakup of CV disbursements, we have recorded a growth, actually it is a low base, so we have recorded over 100% growth across categories of both M&HCV, LCVs and small commercial vehicles, largely on account of two factors. As you are aware the overall growth of CVs in the industry has been fairly high, we typically restrict ourselves to the one to five operators, so most of the delta growth has happened in the CV industry on the high tonnage large fleet operators. So we are not really participating in that segment, but there is an adequate traction on the lower segment as well, and we have been a part of that. Our focus remains on the light and small commercial vehicles, we have actually added about 270 channel sales managers over the last quarter, focused on key channel relationships, largely on the commercial vehicle side, and this has also resulted in a certain amount of traction. Rates have remained more or less constant.

**Chandana Jha:** Kaushik, could you share what is the share of light and small commercial vehicles in our disbursements in this quarter?

**Kaushik Banerjee:** I believe it is about 4.5% to 5%, up from about 2% last year; 1.5% last year to about 4% to 5% of disbursement this year under my disbursement and not loan book.

**Chandana Jha:** Sure. So this 4% to 5% is share in disbursements?

**Kaushik Banerjee:** That is correct.

**Sanjay Chamria:** And just to top-up what Kaushik has said, we after having cleaned up the portfolio quality and stabilized the product mix, as we have mentioned consistently in the past that we want to grow our weightage in the current year and in the future on the used assets and the light and the small commercial vehicles, where Kaushik has a very significant experience and successful track record. And as a result, we have started now building up our portfolio on that front. And as you mentioned, we have invested very significantly in improving our presence in the market by roping in about 270-odd channel sales managers, who will then interact in the chosen markets with the CV dealers and the used car agents to be able to grow this business. So, we hope to see traction on the basis of all these initiatives from the third quarter onwards, having put the portfolio quality issues behind us.

So, while your second question with regard to the margins are concerned, as I mentioned in my inaugural address, that we are comfortable, in fact, earlier I mentioned that we will be comfortable about 7.5%, now we are at about 8.4%. And so any further rate reduction, we would rather pass on to the customer as we also improve the quality of the portfolio. However, if the interest cycle reverses, then also we have a certain buffer here, which is about 50 to 70 basis points. So, therefore, I think we will take call at an appropriate point of time depending upon the market situation and also with the increased presence in the market what kind of a traction we are able to get.

**Chandana Jha:** All right. I have two follow-up questions, if I may ask. Could you share the yields on light and commercial vehicles at this point of time that you are getting? That is number one. And number two, on your liability mix. As we pursue growth and we start growing our loan book, what kind of liability mix, I mean, would it stay around these levels, which is about 70% of bank borrowings? Or are this we would do more of a short-term, I mean, what kind of liability mix would be there, let's say, 1 year - 1.5 years down the line?

**Kaushik Banerjee:** So I will take the first part of the question. So, typically the yield rates that we have on light commercial vehicles is somewhere between 13.5% to 14%. And on the small commercial vehicles it is somewhere between 16.5% to 17%.

**Kailash Baheti:** And on the second part of the liability mix, I think we are going to stay at around the same level where we have presently the banking facilities contributing near about 70% of our borrowings.

**Chandana Jha:** Sure, okay. If I may squeeze in just one small question. On this light and small commercial vehicle, Kaushik, today you said that in disbursements we are at 4% to 5%. What would this number be in your assessment one year down the line? I mean, would it increase to 10% or is there a threshold that we have in mind?

**Kaushik Banerjee:** I honestly would not want to make a forward-looking statement. And as you are aware, for us, the entire intent is portfolio quality. So, depending upon portfolio behavior, we will take a call, in terms of the acceleration or the deceleration of growth in any product, not just small-product categories. So, for example, today we have had a marginal attrition in terms of tractor volumes, but we are looking at a good traction happening in that quarter. And we might come back and look at increasing our presence in tractors again. So, I do not want to go ahead and make a forward-looking statement in terms of what will be the quantum of AUM or disbursement in any single product category. It will be largely on long-term or the portfolio behavior and profitability of that particular product.

**Moderator:** Thank you. We take the next question from the line of Kunal Shah from Edelweiss Securities. Please go ahead.

**Kunal Shah:** So, when we look at in terms of the grading of the branches which we had done across A, B, C, D, E, so just if you can give some color in terms of how the overall collection efficiency has been in, say, A and B, and how the overall disbursements have been? And what is the overall proportion and where actually do we see it going over next two, three years?

**Kaushik Banerjee:** Okay, so I will take this. So we have A, B, C, D, so very quickly, we grade the branches based on our own internal benchmarks into statistical analytics and internal loss. At this point of time I am not in a position to give you the individual branch grading level movement in terms of portfolio behavior. Having said that, and as our MD has pointed out earlier, 27% of our disbursements used to come from A and B rated branches, and they used to be about 35% of the total branch network that we have. That was a year ago. This year 60% of our branches are A and B, and 61% of our overall disbursement is coming from these branches. And so it is also reflected in every product mix as well. So, at the aggregate level there has been a significant improvement in overall portfolio behavior year-on-year. And we probably will be able to give you the definition offline in terms of actual movement at the branch graded level. But right now I would not be able to kind of give that information over the call.

**Kunal Shah:** Okay. And secondly, in terms of overall OPEX to assets or cost to income, I do not know if you have earlier touched upon it. But maybe how do we see it, and what are the controls which we can bring in? And what is the level which we could see it finally settling two, three years down the line?

**Kaushik Banerjee:** So, on the OPEX we are more or less at a level from here that there will not be any significant increase in the OPEX. But as you would appreciate that our assets have been drawn, and in the opening statement Sanjay mentioned that from onwards we are looking at growth in our AUM, as well as growth in our mortgages AUM. So, this growth, as it happens, we will not be incurring additional expenditure, and the operating leverage will come from the growth in AUM.

**Kunal Shah:** Okay. So, largely growth will lead to overall OPEX to assets down?

**Kaushik Banerjee:** Yes.

**Moderator:** Thank you. We take the next question from the line of Antariksh Banerjee from ICICI Prudential Asset Management. Please go ahead.

**Antariksh Banerjee:** Sir, I have two questions. One is, in continuation with this question on OPEX, you have mentioned in your presentation something about management bandwidth, and that has caused an increase in the OPEX. Would you like to elaborate a bit on that? Have you recruited some new management? You talked about some leadership completion of hiring in the housing space. So would you like to elaborate a little on that?

**Sanjay Chamria:** So, as we have been talking for quite some time that we have rebuilt the management team, and now all of us operate from Mumbai under one roof. And obviously, so this is the investment that we have made in strengthening the business and growing the franchise in the future. So this will obviously have some kind of a lag effect. So, now that the management team being fully on board and complete, there is no additional cost that we have incurred. And this, coupled with the marginal de-growth in the loan book, has resulted in a higher cost-to-income ratio. This is what we meant. So this together with the fact that now we do not have to invest anymore, so from Q3 onwards as our AUM starts to grow, the cost-to-income ratio sort of starts moderating into the next few quarters. That is what we meant.

**Antariksh Banerjee:** Okay. And my second question is a little bit related to the liability mix. If I go on slide 22 of your presentation, your bank borrowings have increased from 66% to 70% year-on-year, whereas your debt capital has gone down from 23% to 18%. Is there any reason you are seeing that? And you also guided that bank will remain at 70%, and I mean, based on our earlier interactions I thought you were also expecting a rating upgrade once you start growing. So why wouldn't you want to increase your proportion of debt capital when your rating improves?

**Kailash Baheti:** So, I think you have rightly mentioned that the borrowing mix depends also partly on what kind of a credit rating we have. And the credit rating, the present credit rating, the banks give us a far better cost of borrowing than what we will get from the debt capital market, but at an appropriate time. Once our rating has improved, our AUM has started growing and our rating also improves, of course, the new channels will open up and our cost of funds from the debt markets should also be competitive. And that is when probably we will think at increasing our exposure to the debt market.

**Antariksh Banerjee:** Okay. What kind of rates do we get, I mean, what could be the difference between the bank rates and DCM right now for us?

**Kailash Baheti:** Right now it will be probably a negative of 25 basis points to 50 basis points.

**Antariksh Banerjee:** Okay. And you said your ABF and mortgage would start growing from second half of the year, right? So for the whole year you have a figure in mind that you would like to compare yourself with, say, last year?

**Kailash Baheti:** So, I think whole year we will marginally grow from what we closed the last year at. We have de-grown in the first half and the growth will come from the Q3 itself.

**Antariksh Banerjee:** So for the whole year as a whole it should be better off than last year, right?

**Kailash Baheti:** That is what we are internally targeting.

**Antariksh Banerjee:** Okay. And just one small little thing, regarding the 61% and 28% from A and B branches. So, if I am understanding correctly, 61% of the incremental disbursement cost coming from A and B, right, versus 28% last year?

**Kaushik Banerjee:** Not incremental. If I take the disbursements at 100%, last year 27% of the 100% was coming from A and B branches.

**Antariksh Banerjee:** Okay, it is the contribution, okay.

**Kaushik Banerjee:** That is correct, the contribution.

**Moderator:** Thank you. We take the next question from the line of Umang Shah from Emkay Global. Please go ahead.

**Umang Shah:** I have one question for Kaushik, again, related to the A and B branches. So, is it fair to understand, so if I look on a year-on-year basis, clearly, the number of branches that fall into the A and B category and the share of these branches into our disbursements has gone up substantially. But, obviously, our overall disbursements have not grown as much. So, is it fair to assume that for the C and D branches we have cut down the disbursements in a meaningful way? And for us to incrementally, the kind of targets that we are setting for ourselves in H2, what are we expecting in terms of the C and D branches getting converted into A and B? And would we see further increase in the contribution from the A and B branches? So I just wanted to understand that mix.

**Kaushik Banerjee:** Okay. So Umang, let me take this in two parts. One is in terms of our deliberate kind of effort to kind of restrict disbursements in C and D branches. Let me just correct that perception. A branch is rated A, B, C, D based on the sigma total of all the products in a particular branch. Let us assume that we have nine products that we finance, it is possible that a particular branch may have a dominant product which has a low rating, and therefore that will reflect in the branch's overall rating. There will be other products in a particular branch, could be an A and B product. So, the way I would respond to this question is that, we are consciously encouraging and promoting a higher amount of disbursement in A and B products. And we have a set of parameters in place to correct any disbursement in the C and D products, alright? So basically, as and when a branch moves out of C and D in the product grade to A and B, the product is automatically comparative for them to finance. Okay? And yes, to your other point, we are constantly trying to ensure that the C and D branches move into A and B categorization. That is the mandate for the business seems to deliver.

**Umang Shah:** Okay. So technically, let us say, if I was to look at a disbursement per branch kind of a number, then that would pick up only once the overall… So technically, A, B, as well as the C and D branches start contributing, only then we start seeing that operating efficiency kind of coming in?

**Kaushik Banerjee:** Yes. So technically we have seen that movement last quarters, in Q1 we actually had 15% or 20% gap in terms of disbursements over Q1 over Q1. In fact, this year we are about Rs. 20 crores ahead, Q2 on Q2, in terms of overall disbursement, okay? So the paradigm shift has already begun to take place where the gap in terms of disbursements on C and D products has been kind of offset by the increase in disbursements in A and B products. I would say continued improvement in portfolio behavior, the growth over the previous year's quarters will continue to improve.

**Umang Shah:** Understand. The second question was relating to our asset quality, it has remained fairly stable. Last time you guys had indicated as to what was the movement on 90 DPD. How does asset quality track this quarter on a 90-day basis?

**Kailash Baheti:** So Umang, our 90-day basis book, the 90-plus book has actually again reduced this quarter from what it was in the last quarter.

**Umang Shah:** Okay. So, second consecutive quarter of improvement is what we are seeing in the 90-day book?

**Kailash Baheti:** That is right. There is a reduction of about Rs. 23-odd crores in this quarter as well in the 90-plus book.

**Umang Shah:** Okay. And we are not yet disclosing that number, right, the 90-day number?

**Kailash:** I mean, it will be there on 31st of March, 1.7% is what we would be having in 90 to 120 buckets.

**Umang Shah:** 1.7%? Okay. And this is as on September?

**Sanjay Chamria:** I think, Umang, in addition to what Kailash has mentioned, I would like to state, in the beginning of the year in the call I had given a guidance that this year we are looking to reduce the overall 90-plus by about Rs. 150 crores to Rs. 200 crores in terms of absolute amount. And I also mentioned that while our AUM will de-grow in the first half and it will start growing from the second half of the year, and for the year we will have a nominal AUM growth. So, we are pretty much on track in terms of the GNPA reduction. So we have overall achieved a reduction in the 90-plus of close to Rs. 100 crores already in the first half. So while we had guided that we will achieve about Rs. 150 crores to Rs. 200 crores, in my view we will probably do more than Rs. 200 crores, because we have already done about Rs. 100 crores in the first half. This is in terms of the GNPA how are we moving. So as far as our AUM is concerned, that has again de-grown by about 1.4% in the second quarter. I have also mentioned in my opening comments that, now this is the last quarter where have seen a de-growth. And going forward, both in the vehicle finance as well as in the mortgage, we are going to see the traction in the AUM growth. And with the AUM growth happening and the GNPA and absolute amount reducing by another Rs. 100 crores, I think we will have a domino effect in terms of the GNP, NNP as a percentage to the AUM.

**Umang Shah:** Understand. That is helpful. And sir my last question is for you. Yesterday, the exchange release mentions that the Board has given an approval for a fund raise to the tune of about Rs. 750 crores. If you could just elaborate, are there any timelines in mind as to why when we intend to raise this money?

**Sanjay Chamria:** So you see, this is an enabling provision which we thought that we would take from the Board and then approach the Shareholders for their approval as per the company's act requirements, and this approval will be valid for a period of 12 months. So, as we have put the asset quality issues behind us, we have got the full management team on board, and they have also spent about six months to one year in the company. And therefore the confidence level of the management team is fairly high in being able to steer around the business of the company and start showing growth. And as we have discussed also that once the growth starts happening, then we may need to raise capital, now which could be one quarter or two quarters away. So, by having an enabling resolution from the board and the shareholders, it improves our flexibility to be able to time and raise the capital as and when we need it and that it is available in the market.

**Moderator:** Thank you. We will take the next question from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

**Manish Ostwal:** Most of the questions are answered, only one question one have on the provision coverage ratio. Currently we have 24% within coverage ratio, and when we compare to our peers this is one of the lowest. So, how do you see this coverage ratio going forward, whether we will want to increase it or it will remain here where it is?

**Kailash Baheti:** So, the provision coverage ratio obviously is one defect that we had sold the entire high bucket NPAs last year and we did not have anything coming into this year in 730-plus. Specifically, our PCR would be lower compared to our Peers who may have NPAs in higher buckets. Having said that, we do realize that the PCR is one of the benchmark and this quarter there has been a significant jump in the provision from 20% to 24%. I think this journey will continue.

**Manish Ostwal:** Okay. And the credit cost guidance for the full year, we maintain their guidance, right, sir?

**Kailash Baheti:** Yes.

**Moderator:** Thank you. We will take the next question from the line of Praful Kumar from MSD Partners. Please go ahead.

**Praful Kumar:** Just wanted to take a two, three-year view and want to understand in terms of now growth. I just wanted to understand in next three years in terms of growth what are we looking at, in terms of any guidance on the 2020 numbers, in terms of growth in each of the businesses? Because we have got the teams in place now, and we are looking for growth, we are looking at a 25% CAGR on loan growth over next three years? Or how are you benchmarking growth for us?

**Sanjay Chamria:** So, Praful, as we have stated very clearly, sequentially, the priorities for the organization and the management team, the priority number one has been the portfolio quality. The priority two has been the building up of the management team and then making sure that we then build the business on the sound healthy profitable lines. So, I think more than half of our structural reforms have been completed in the last 18 months. And now the entire management team and the organization is geared up to growing the AUM on the sound healthy profitable lines. Having done that, this year, as I mentioned that the AUM growth will be marginal, because having seen a de-growth of about 4% in the first half we want to wipe it out in the second half and have a nominal growth this year. But from next year onwards, which is what we expect, a normal year, so the industry also is growing between 15% and 20% in terms of per year AUM growth. And we would not like the industry, this much I can say. But focus would remain on maintaining the NIMs, and the overall ROAs and the profitability, because that is what eventually we will return to the shareholders.

**Praful Kumar:** Sure. And secondly, any levers in ROA through the operational efficiencies to come in? For example, you talked about doing a lot of business direct versus through DSAs, because that will save a lot of turnaround time, commissions. So any more efficiencies that you want to talk about that can be ROA drivers as well over a two, three-year period?

**Sanjay Chamria:** So what I will do is this, I will first answer at a broader level, and then Manish, who is on board as the MD and CEO for the housing and SME, and this is more particularly in case of the affordable housing, so he will then take a shot at that part of the answer. So, in terms of the organizational operating leverage, I think the moment the AUM starts growing and the insurance business start growing, we have a common infrastructure of 300-plus branches, IT, HR and finance, and therefore, the costs will be spread over a larger business. And that will give us the operating leverage. The second leverage and the improvement in the others that we expect to come through is what we have shared with the investors earlier, that by end of March 2018, about more than 75% of our total AUM will be under the new regime, which is under the branch banking structure, which was started in December 2015. And we are seeing the asset quality of this business is 35% superior compared to the older business. And of the balance 25%, which is the older regime, the 55% had already peaked by March 2017, and the entire 100% of that 25% portfolio would have peaked in terms of NPAs in this year. So, therefore, from the next year onwards we also expect to save a lot in terms of the credit cost to the overall AUM. So, therefore, the leverage in terms of the profitability improvement will, one, come from moderation in the cost to income ratio; and second, a substantial reduction in the credit cost. Now, I will hand over to Manish to take your question in terms of the direct marketing, and affordable housing, and in SME, what and how he proposes to do.

**Manish Jaiswal:** Thank you, Sanjay. Just to give you a sense about the two businesses, one is mortgage and second is SME. We are tracking well on the ROAs on these two businesses at 2.2 and 2.4. And very specifically, in housing, we have taken steps towards going direct and going more towards affordable home loan. And in the last six months' time we have grown our front-end by about 33% and we expect this number to actually double in next quarter itself, where we are moving very consciously towards direct sourcing model. So, it gives us two benefits, one very clearly is on the OPEX front because of the DSA payout element, and we have a cost save there. And secondly, it also connects directly to the market and helps build franchise. So these are very specific interventions which we have initiated in last quarter onwards. And we expect to over time by the end of March have more than 50% of business, which is incremental business being sourced, will be direct business and which also will be home loan business.

**Manish Jaiswal:** How many branches, Manish, are doing home loans today? And what that number was three months back and what that number will in the near future?

**Manish Jaiswal:** So, we currently operated around 85 locations, put together, and we have not yet began to sweat out the overall Magma infrastructure. As Sanjay has already mentioned that we were in the process of completion of our leadership deck, which we have, and by this December we would be in a good position to build our product policy and processes, so that by next quarter onwards we are in a good position to scale up and ramp up the business on a larger canvas. That essentially is our goal. And as I speak to you, quarter-by-quarter we have begun to grow in this business. I think it not only helps the mix change, the mix is more oriented towards home loan, a bit of we are deflecting away from LAP, and we are moving more towards direct. So we expect a more significant growth perhaps in next quarter, and I think the early trends look positive.

**Praful Kumar:** Sure. And in terms of SME, my last question. SME, now you talked about initially when you came on board that it will be now a lot more secure because it is all unsecured today. So how is that strategy shaping up, any number that you want to give us, any details on the business model that give your volume on the secured side?

**Manish Jaiswal:** So, as I did mention in last quarter, and I again reinforce, it is a bit of a misnomer. We already are doing secured SME, its construed as LAP. The whole point is that how do we build up cogent strategy and synergize on the existing business of unsecured, and secured on the other hand which is at a very good LTV, the average LTVs in fact are in the range of around 50% of our mortgage book. So if we look at that we already have that inbuilt in the organization, it is a matter of synergizing. So we will be building very specific strategies, and in actually implementing as we speak in terms of securing our SME book. And so that we have an overall good balance of both secured and unsecured.

**Moderator:** Thank you. We will take the next question from the line of Shubhranshu Mishra from Motilal Oswal Securities. Please go ahead.

**Shubhranshu Mishra:** Most of my questions are answered.

**Moderator:** Thank you. We will take the next question from the line of Bunty Chawla from B&K Securities. Please go ahead.

**Bunty Chawla:** My questions already been answered. Only one question. Yesterday RBI has come out with, RBI released the new outsourcing norms for NBFC, so we would like to have your view on that.

**Kaushik Banerjee:** I think the guidelines that you know have been released only yesterday, and we do not have any significant outsourcing. So, I can assure you that it will not have any significant effect on us. But how specifically it may impact others or the industry, I will not be able to answer right now.

**Moderator:** Thank you. We will take the next question from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

**Deepak Poddar:** Now, sir, my question pertains to, you have explained the strategy, basically, next year the credit cost to moderate, and we expect about 50% from direct branches and even the AUM and the new regime will increase. And you also talked about ROA improvement trajectory to continue. So, currently, we are at basically 1.5%. So what sort of steady state ROA we might be looking at considering all the improvement that you have mentioned, maybe over next 1 - 1.5 years?

**Kaushik Banerjee:** It is difficult to say what kind of ROA we will be targeting. Our ultimate target should probably be at about 2.5%, - 3%. But right now, saying where we will be, would be premature.

**Deepak Poddar:** Okay. But a 50 basis point improvement at least or given all the factors that you mentioned?

**Kaushik Banerjee:** Sure, that is the minimum we should target.

**Moderator:** Thank you. We will take the next question from the line of Umang Shah from Emkay Global. Please go ahead.

**Umang Shah:** I just have one question. In this quarter, we have merged MITL with the parent Magma Fincorp. Could you please share, I mean, what is the consideration paid for the minority stake?

**Kailash Baheti**: So we acquired the minority stake at the book value which was about Rs. 34 crore.

**Moderator:** Thank you. We will take the next question from the line of Srijonee Bhattacharjee from Cogencis. Please go ahead.

**Srijonee Bhattacharjee**: Sir, I just wanted to, so you have been talking about reducing the OPEX, right? And in our interactions, we have spoken about some tie-ups that were going to come through. What is the development on those?

**Kaushik Banerjee:** Sorry, we did not talk about any OPEX reduction per say or absolute OPEX reduction, we feel that our OPEX is reasonable. We said that since our book has been de-growing, the impact is not visible on the OPEX ratio. And since from the current quarter onwards, we are targeting AUM growth, automatically, the impact would be visible on the OPEX ratio.

**Srijonee Bhattacharjee**: Okay. But are you relooking some of your branches, like are you trying to reduce some of your branches or are you trying to sort of tie up with some other payment companies or something, payment bank?

**Kailash Baheti**: No, we are not. We already have an all India tie up with one or two of the leading banks wherein the customer can directly deposit the money. And also, our own employees in the field go and deposit the money directly. So, we are not looking at shutting down any branches, but to add more color, I think, Sanjay would like to say something.

**Sanjay Chamria:** I think now we are getting into a growth mode and we have been opening branches after we move to the branch banking structure. And in the last two-odd years, that is from December 2015 onwards, so about 21 months, we have actually added more than 50 branches in the company. But for the fact that we have been setting the portfolio quality right, we have not leveraged these branches in terms of generating additional business. So there is no question of shutting on branches. On the other hand, in fact, yesterday we had a board meeting, and coincidently yesterday we opened one more branch. So we are looking to open more branches and penetrate more at a taluka level, so as to retain the USP of our franchise to cater to the disenfranchised lot in the rural and the semi-rural markets. This is one or sure. Second is, we have also been digitizing front-end part of our business post demonetization where we saw that the digital payments have increased. And just to give you a color, now almost about 2% of our field collection is actually coming through the mobile payment route, wherein even our customers who are truck drivers, taxi drivers and machine operators, they are using the mobile app and using BHIM UPI to pay their installments towards and we hope to see that increasing in the future, which may give us more leverage in terms of the cost.

**Moderator:** Thank you. We will take the next question from the line of Umang Shah from Emkay Global. Please go ahead.

**Umang Shah:** Sorry to come back again. On this MITN acquisition, so now that we have kind of acquired the residual stake, I mean, in any way does this kind of impact our tractor financing business or the JV arrangement with international tractor kind of continues?

**Sanjay Chamria:** So, Umang, one, we are happy that if you are coming back and asking more and more question, that shows your increasing interest, and we are happy at that. So you do not need to feel sorry about it. But coming to your question, the relationship with the IPL and with the promoters, Mittals, remain absolutely intact. And the same arrangement is now continuing in the parent company, which is Magma Fincorp, the arrangement that we had in MITL for financing the Sonalika brand of tractors. After about 10 years of relationship wherein we felt that now the business has become mature, and it has outlived its utility of having a dedicated company to finance Sonalika tractors with the transfer pricing mechanism from the parent company, because eventually we are using the same infrastructure. So, therefore, it was a very, very cordially decided that we will acquire the 26% stake at a book value, then fold up the company into the parent company. So yesterday we have also passed a resolution now to merge MITL into Magma Fincorp, and thereby have a much simpler corporate structure. And we continue to finance the Sonalika tractors with the same vigor and on the same commercial terms as we were doing in the JV company earlier.

**Moderator:** Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to Mr. Pradeep Agarwal from PhillipCapital (India) Private Limited. for closing comments.

**Pradeep Agrawal:** So my question is, what kind of traction are we looking at in affordable housing segment? And any specific geography where we are seeing more traction than other geographies?

**Manish Jaiswal:** I think it is more of a base effect. And in the overall context, I would like to say that the growth in affordable housing will be significant. And as I mentioned that we are looking at doubling our front-end, and there could be a three-month productivity lag when the front-end comes in. As I speak to you, from April onwards till now, we have almost grown our front-end by 33% and we will double our front-end by March. So, I mean that should kind of give you some indication of the story to come in the housing finance piece. And I will also mention that we believe in a three key themes which is, go direct, go towards affordable home loan, and dig deep. So we have seven states which we have identified as a part of initial strategy, given the strong depth which Magma has already in terms of presence and brand presence in these markets. And it will be mutual synergy, and we tend to leverage deeply in the seven states.

**Pradeep Agrawal:** Okay, sure. And any state support you get in this segment in terms of promoting this product?

**Manish Jaiswal:** I am sorry, what was the question?

**Pradeep Agrawal:** Any state support you get in this segment?

**Kaushik Banerjee:** Yes, we get a lot. I do not know what state support means. Do you mean the government support when you say state support?

**Pradeep Agrawal:** Yes.

**Manish Jaiswal:** Yes, certainly. I would like to mention that the PMAY scheme is perhaps one of the best scheme launched in the last 50 years by government which is most susceptive. The amount of subsidy transmission and efficiency of transmission is actually revving up this sector. The affordable sector is growing at a rapid pace, despite a stagnation in the world mortgage industry. And not only is the government subsidy between Rs. 2.33 lakhs to Rs. 2.67 lakhs per drilling unit is the support coming from central government, two more states have come forward and they have begun to offer initial capital of Rs. 1 lakh each. So which means that a consumer essentially may ask and buy a dwelling for a small amount of Rs. 50,000 to a Rs. 1 lakh for affordable housing costing about Rs. 12 lakhs to Rs. 15 lakhs. So, there is a lot which the state is doing in forms of the capital subsidy, and that really will be one of the prime drivers for the industry. I hope that answers your question.

**Pradeep Agrawal:** Yes. That is perfect. That ends the call. So I would like to thank the management for giving us the opportunity to host the call. Thank you everyone for joining in the call today. Have a great day.

**Sanjay Chamria:** Thank you.

**Moderator:** Thank you very much. Ladies and Gentlemen, on behalf of PhillipCapital (India) Private Limited, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.