"Mahindra & Mahindra Financial Services Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Mahindra & Mahindra Financial Services Results Conference Call hosted by JM Financial. As a remainder 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 "*" followed by "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Karan Singh Uberoi from JM Financial. Thank you and over to you Sir.

Karan Singh Uberoi: Good morning everybody and welcome to Mahindra & Mahindra Financials Services earnings call to discuss the Q1 FY'14 results. To discuss the results we have on the call Mr. Ramesh Iyer who is the Managing Director and Member of Group Executive Board, Mr. Ravi who is the CFO, Mr. Dinesh Prajapati who is the Senior General Manager, Treasury and Corporate Affairs, and Mr. Rakesh Bildani who is the Manager, Treasury. May I request Mr. Ramesh Iyer to take us through the financial highlights subsequent to which we can open the floor for Q&A session. Over to you Sir.

Ramesh Iyer: Hi, morning. What I thought was instead of really speaking individual number, because everyone will now have the number already with you, I will kind of express to you what is guiding the whole philosophy of the first quarter and how do we look at it going forward from here. Summarily, I think it is a satisfying performance as far as we are concerned and we have not seen any new shock or a new trend that I may want to bring to light specifically. Interestingly, our philosophy of multi-product approach and going more deeper is working well and that is actually helping us gain volumes and our market share in many of the products and that is one of the reasons why we are able to maintain the growth rate in spite of the fact that the market is not very favorable when it comes to the overall auto industry. Just kind of an additional factor to this, if you look at the Maruti statement, they have also gone ahead and said that while they are expecting a growth but they are expecting a much higher growth from the rural market and we have actually witnessed this at the ground level, not just for one product but we have witnessed it for almost all manufacturers reaching that market, and many more are coming more deeper and we believe that, that is going to help us go further. As far as tractors, after a continued subdued performance over the last few months have in this quarter really bounced back to show some decent volumes and we are the direct beneficiary of also that volume. I must add here that given the competitive space which otherwise was discussed and expected to be more sharper we do find that people are much slower in terms of their wanting to expand or participate for very simple reason that each one has different sets of activity to handle and therefore we do find the respect for a model like ours is gaining momentum. So on the volume front, we continue to believe that our deeper penetration we have added 15 odd branches in this quarter and going forward we are not relooking at opening up branches. We are bullish and we are saying we want to continue in this path of opening 30, 40 branches and that will help us go more deeper than where we are today and that will help us protect the volume and we have become a kind of decent player also in our secondhand vehicle financing and that is moving up on a QoQ basis every time that we discuss, and there has been a slight movement over there, but one thing I may want to very categorically mention here is that the growth is not at the cost of sacrifice to any of the processes, policy or control. We continue to lend not more than 70% as our LTV even today as we speak. Our period of lending is not changed, it continues to remain in the range of 29, 30 months bucket. We have not kind of introduced any product for buying up market share in the sense of dropping interest rates, etc. to gain market share. We are very clear in our minds that we were expecting of course for sure that interest will come of in the last three to four months, and therefore we did not increase our lending rates over the previous cost that we have incurred, but that has not happened and I would think that is one of the lowlight of this quarter that against expectation of interest coming down it has not happened and to that extent one would see that we are not covered, but as we are on the subject I want to tell you that in anticipation of going forward no drop possible rather only an increase possibility. We have already pushed up our lending rates to most of our products, rather for all of our products in all the geography. Our expectation is that the dealers and the manufacturers may step in at this stage and try and provide support and subvention, and try to reduce the burden on the customers, but from our side we have gone ahead and increased the lending rates to protect that. So I want to stay clear to say that we are not going to sacrifice on our lending rates for the volume. We are staying clear to say that we are not increasing the LTV to support volume growth and I want to stay clear to say that we will go deeper, open more branches to ensure that the momentum of growth is not sacrificed and we will not overgrow on any particular product in terms of gaining market share. We have a restrictive market share approach to most of the product and that will continue to be maintained. The heavy commercial vehicle segment which has been very, very underperforming segment for the last may be 12 months plus, we had already curtailed our disbursement to that segment and we will continue to maintain that stand of ours of not really going deeper in the heavy commercial segment. So our focus on as far as the commercial vehicle segment is restricted to LCVs and we do not want to kind of increase our exposure to the heavy commercial vehicle segment that is the stand that we are very clearly taking. As I mentioned, our forecast continues to be that it will only go up and not come down as we move along and as I just said we have pushed up our lending rate to protect our margin. The product mix change definitely builds pressure on the yield and therefore one would see a little compression to the yield not necessarily coming out of our inability to pass on, it has actually come out of the mix of the product and clearly the expectation when we do businesses at different yield rates is that the overheads to run this businesses and the quality of asset of each of this business is supposed to ensure that the return on asset is not sacrificed when we get into low yield product. Just to give you a range amount understanding, on the car segment our yields are anywhere about 13, 14 and the tractors could be higher at 17, 18 and the secondhand could be at 25, 26 kind of a level. So when the product mix changes one would see that the yields therefore coming down a little, but clearly one has seen the overheads also have come down during this quarter on the overall asset basis. So to some extent we are benefited by the overheads being under control and we do expect that the quality of asset in each of this segment will also protect the low yield decisions that we take on lending.

Now coming to the quality of asset, I want to clearly categorically mention to you that, if you historically look at first quarter of any particular year in the past, you would see the range of our gross NPLs have always been anywhere between 3.9 going up to 4.6 in certain quarters and therefore we are not overly alarmed by the fact that asset moved up a little, and if you kind of even look at sequentially from March to this particular quarter end on an absolute basis if the volumes have increased move than ever before, a simple reason for that is if you have done about 500,000 contracts in a 12-month period, by natural basis of this business and the geography one would see a volume increase that is happening and therefore the 4.2 level of our gross NPLs is not something which is overly concerning to us and it does definitely put extra concern in the sense of our focus on this activity will be much higher than ever before because we would only expect that the way the season is coming out, the monsoons being good, the first indicator of the tractor sales are definitely a positive indicator of the monsoon coming out to be much better would only help us as we move along and as we close the year that this number would come back to where it actually belongs to. So if you look at historically any first quarter of the previous year, you would see a similar range amount of the gross NPLs moving up, but simultaneously what has happened to us is the coverage has come down and therefore one may want to understand as to if the coverage is coming down are we kind of comfortable at this level of coverage. I think I again would like to mention to you this we explained even in the last quarter, that when you have a new set of customers who come into NPL and the high provided once actually move out of the NPL you have the NPLs at a low bucket and therefore the coverage looks to be low, from our perspective we think it is a positive sign that you have fresh contracts which have come in as a fresh NPL therefore they are much easily handlable in terms of corrective measures are possible rather than a very old NPLs not getting out of the book, therefore if the same NPL for some reason, let us imaging that the same NPL contracts continue till the year end then you would see obviously the coverage will continue to go up because they will change bucket, but if they were not to be in NPL and they get out and a new set of customers come into the NPL you will see the coverage ratio remaining low. Therefore interestingly we always measure to see that what is our coverage and what is the gross NPL. If the gross keeps moving up in one direction much higher and higher and the coverage keeps coming down that is really the cause of concern that we will really alert ourselves too, but as we see in a one-year horizon if the number of customers who come into NPL and the number of customers who go out of NPL is in the range that we are always seen to then there is nothing much to really concern about. If you kind of split this entire NPL portfolio and you say that if there are customers who are more than one year old in the book, what is the coverage, I think our coverage would be more than 90% for such customers who have changed buckets. So there are a lot of high provided items, which go out, and the new ones which come in, therefore they carry a first bucket provision and therefore one would see is the coverage adequate or otherwise. With the monsoon as I explained to you, we are very very comfortable that if this is the way the season kind of unfolds itself going forward one is expecting that we will have a good second half in the sense of festival season as well as one would see a good harvest coming out of that. There are already indicators of good crop coming out of the Kharif and therefore one is expecting that the cash flow buoyancy will continue to be maintained. Just one another factor of understanding is when we transact on her secondhand vehicle we also track for the resale price that we get and the loss that we need to book, and we are very comfortable to look at any of the product that we look at on a total basis. We incur a loss of about Rs. 6000 to Rs. 7000 per vehicle when we sell them finally. So therefore if one has to consider that that is the loss and that is not very different from anytime in the past, but within the product range we have seen some very very positive signal, like tractors are actually making no losses. Secondhand vehicles do not make losses. The area of concern if you ask me from the overall asset quality perspective, I would think are two. One, the southern market is yet not behaving the way one would have wanted them to. One is waiting to see in this season what changes happen. Already signals of Karnataka and Andhra are available with us, with tractor sales picking up and the cash flows improving. We do expect that these two states for sure have started showing positive sign. The other one is the commercial vehicle segment, which continues to remain sluggish. We have a small exposure, though we are not increasing the exposure, but being high-ticket item and if they come for provision and if they are not there in the first quarter of last year, you would see the provisioning increase arising out of this product. So summarily I would say, as far as the quality of asset is concerned, while one has seen a little increase to the gross NPL, they are not alarming and they are not very different from the trends that we have seen in any first quarter of the previous years. Season unfolding is felt to be much better what one is seeing from here. We do expect that there are very very high chances of us able to correct the situation. Internally, we have taken few steps in order to address this requirement. We have already formed teams, which will focus on different buckets of collection. We have already created mentors who will handle certain branches, which require additional focus, and we have also started looking at different products being addressed very differently. We have already taken decision as I mentioned to you on the heavy commercial vehicle, we are completely you can call us out from that particular activity more or less, and we are definitely focusing only on the UV, tractors, cars, and secondhand vehicle segments for our growth, and we believe that itself is voluminous and that itself is available enough in the rural market from various manufacturers who are looking at that market and our continued penetration going more deeper and adding more people on the street is the direction that we are taking from here for our future of growing this balance sheet as well as correcting the asset quality. So I would think that interest cost going up will be offset by more or less increasing our lending rates, quality of asset with better recovery happening in the second half should see itself correcting, not focusing on the heavy commercial vehicle for growth will itself bring in reduced pressure on the product-based quality change if any, and some of the states which otherwise are not doing too very well, with this change scenario of a better monsoon, better power situation, etc., therefore economic activity at least in these states go a little more than what it is currently will ensure that the cash flows are much much better, and our deeper penetration through additional branches and more people on the street gives a story that we would want to place on tablet for looking at the future from here on for this year. What I can do is, Dinesh or Ravi, anything particular on the number you may want to add or we will leave it open to questions and then we can handle it. I think, this is what we would like to say as summary. Just two more things, on the two subsidiaries of us, they also had their accounts and you will see rural housing in terms of the behavior pattern will be exactly in line with Mahindra Finance behavior since they also have activities in southern market, etc., you would see a little kind of slowness in their activity in the first quarter, but they will go exactly in line with Mahindra Finance growth going forward in terms of the market behavior. As far as insurance is concerned, they are directly dependent on the volume that these two businesses transact, and since the volumes have been good, we have seen a better return from the insurance business. With that, I think we come to the summary of what we think is the outcome of our performance for the first quarter and little are going forward, and I can now leave it open for questions, and all of us are hear to take them.

Moderator: Thank you Sir. Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Ashish Sharma from Enam Asset Management. Please go ahead.

Ashish Sharma: Good afternoon Sir and congratulations on the good set of numbers. Just on the growth front, we have sort of done very well, do you expect this sort of buoyancy in across segments continue especially in the tractors, we are sort of grown at quite a healthy pace, just some color on that Sir?

Ramesh Iyer: As far as tractor is concerned at least most of the manufacturers that we are in touch with, we understand the markets continue to show the trends of being very positive. Interestingly, if you look at even in the previous rounds the northern market was buoyant. It was the southern market and Maharashtra in particular, these five or six states, which went a little slow, and it had a little extra impact possibly on M&M since they have a larger market share in these markets. Now clearly, these markets have opened up after the monsoon and during the monsoon, and you have seen even M&M numbers, I am sure that they have also shown upward of 20% to 25% growth during this period, and the indication seems to be positive going forward. As far as, I just said Maruti themselves have said that they are going to focus much on the rural market for their growth. They are talking of 19% to 20% growth coming from rural market, etc. I think most of the car manufacturers, we are now working with almost all of them and all of them are indicating that they are focusing on rural, setting up dealerships, going more deeper, etc., and secondhand vehicle of course, in a sluggish market like this many do not want to venture buying new, look for secondhand vehicle. It is actually an opportunity for somebody like us. So I think asset growth I may not want to put too much of pressure of not able to do that. This is what we hear from the market, from various manufacturers.

Ashish Sharma: Okay. In terms of opportunities, specifically the tractor segment growing a little higher or we sort of want to be a little cautious in that because I think the opportunity is there to grow aggressively the tractor segment this year?

Ramesh Iyer: No, I think internally we always have this cap of not doing more than 30% of any manufacturers market share, it is just Mahindra and Swaraj together. About 18% to 20% of our balance sheet will continue to be tractor. So we are not looking at tractor replacing any other product for growth. It is going to be the approach.

Ashish Sharma: Okay. Just some colors on the spike in gross NPAs, which segment actually contributed the big chunk, was it sort of across segments?

Ramesh Iyer: No, as I mentioned right in my address that it is something from the southern market which went a little slow and something from the commercial vehicle which is not doing well, otherwise we have actually seen much improvement or much much curtailed activity on the negative side as far as tractor is concerned or LCV is concerned or the UV is concerned or car is concerned for that matter. It is basically more geography rather than product by itself and within the product if at all one ask us, we have a very small exposure though, but it will be from a commercial vehicle, which was not there virtually as a provision in the first quarter of last year.

Ashish Sharma: Okay, lastly some color on the net interest margin side, because we have sort of taken increase in the lending rates and the RBIs action in the last couple of weeks, do we see some impact on margins because of that or we sort of hedged ourselves by increasing lending rates?

Ramesh Iyer: We have increased our lending rates anywhere between 50 basis points and about 80 to 100 basis points, average could be 60 to 65 on different products, but one does not know if the borrowing cost is going to be even more higher than this as we go along then we will take a view too, but as of this date without us incurring any increased cost we have taken this call to increase the lending rates.

Ashish Sharma: Okay, for Q2 as of now with the present conditions, you do not anticipate any pressure on margins from here on?

Ramesh Iyer: Not from the market side, but if the borrowing cost has to suddenly spurt, immediately we will not get the benefit from the market, because you will pass on and the benefit of it will come over a period of time.

Ashish Sharma: Okay. In terms of our ALM, where do we in terms of repricing of our assets, do we sort of have a positive gap in terms of repricing?

Company Speaker: As far as ALM is concerned, as we have been saying, always we are fully matched, in fact liability maturing afterwards, but as we have been speaking that almost 50%, as of June there was 45% of our liability coming from the banking segment which is linked to purely base rate. In the even the repo rate goes up and the banking segments start pushing up the base rate there is a likely chance that the base rate increase will have an impact on our liability cost. To that extent, interest rate sensitivity will prevail, but not on the ALM front.

Ashish Sharma: Perfect Sir, thank you, if any further questions I will come back later.

Moderator: Thank you. Ladies and gentlemen we would request you to limit your questions to one per participant as there are several participants in queue. The next question is from the line of Shrinivas Rao from Deutsche Bank. Please go ahead.

Shrinivas Rao: Thank you very much. The question I have is, in general we are seeing the finance companies actually growing much faster than the underlying growth in GDP, even if you adjust for inflation. How is this happening? We have seen very strong numbers in used CV also from Sriram. Is it that organized players are taking market share away from the traditional sources of financing, how do you explain that Sir?

Ramesh Iyer: I personally think though the commercial banks who are occupying the retail space are definitely slower than they were before. That is one clearly available volume for others to participate in. As far as we are concerned particularly, in the overall growth scenario, definitely the rural growth has been much much better than the urban growth. Therefore we have got the benefit of that growth. I may not know much on the used vehicle that you mentioned of Sriram, but particularly I think that when the market is going slow for new vehicle, but if there is a demand for vehicle requirement to use, people do resort to buying secondhand vehicle because that is less CapEx for the same freight that one earns.

Shrinivas Rao: Two more questions. One is, tractor growth has been, as you said, driven by very high growth rates in a few markets. (a) Is it getting more broad-based now, are you seeing that phenomena or it still is driven by clutch of a few markets doing extremely well?

Ramesh Iyer: I think the ones which were doing well earlier continues to do well at Madhya Pradesh, part of Rajasthan, part of Punjab, etc., but I think very interestingly what we have seen which has contributed to growth during this period have come from southern market and Maharashtra, all of them were very very slow last year.

Shrinivas Rao: Finally, you did comment on the used vehicle values, and you still do not see any major losses when you have to repossess and sell, those numbers are pretty much in control, is that right?

Ramesh Iyer: In a scenario like this, I would expect that the used vehicle price should hold on or move up. If there is a demand for a vehicle need, but do not want to buy new, I think the secondhand should hold on better.

Shrinivas Rao: Fair enough, thank you so much Sir.

Moderator: Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: I just had a question on pricing power, if this sudden increase in interest rate continues for a prolonged period of time, because the pricing power with some of the private banks moving towards the same product segment that you are in, with your borrowing from private banks and other banks, and they are actually lending to the same segment, they can always cut you because urban India is not growing that much, and everybody is focusing on rural India.

Ramesh Iyer: I think, first of all the definition of rural has to get more clearer for people who say we are wanting to enter rural India. For us, rural India is a deeper pocket, moving away from urban is not rural from our point of view. Therefore, if you look at private banks from whom we borrow and if we were to say that they are competing in the same segment, it will be very very limited geography where there is an overlap. Outskirts of urban and going close to the semiurban market, there will be some overlaps which will be happening, otherwise when we say rural, we are talking of going more deeper, we are talking of our customer in a lakh and 70,000 villages which is were Maruti or Hyundai or Ford or somebody is excited to work with us to say, can you take us to more deeper pockets. Otherwise people are not interested if I was to go and crowd the same dealership where others are available to finance, I do not think they need us.

Amit Premchandani: So you are not at all worried about 8% to 9% margin continuing or maybe going down?

Ramesh Iyer: In my opinion, as I said, we have increased the lending rate and this is actually a call to the manufacturers and dealers that if the see that if such increase in interest cost makes the selling more difficult, then I am sure they will have to sacrifice their marketing budgets and participate in subvention and we have seen it in the past. Ultimately, we are only an enabler. The more worry of not able to sell should go back to people who have invested huge sums of money and running dealerships, therefore they will not allow sales to come down just because enablers are pushing up cost. For example, if you look at the fuel price increase, what is anybody able to do, people have to pass it on to the beneficiary of using the product and it gets absorbed. Likewise, interest is the next big cost for any buyer of a vehicle and if he is not willing to buy a vehicle because the interest cost is high, but there is need for a vehicle, I am reasonably sure the manufacturer and dealer will step in with subvention. Will they subvent the whole of such increase or will they give a part of such increase, I think that is a call, but in a scenario like this the first thing that gets cut from any balance sheet is the marketing cost and that cost gets translated into an enabler cost and therefore protected.

Amit Premchandani: Thank you Sir, that is it from my side.

Moderator: Thank you. The next question is from the line of Amit Ganatra from Religare Invesco Asset Management. Please go ahead.

Amit Ganatra: My question is on growth, if I look at the overall disbursement growth, it basically is largely out of low base, but it is happening in the products which you just mentioned that they are high yield products, and also you mentioned that the yields are in line with whatever operating cost as well as the credit cost that we expect. If that is the case, it does mean that in future one should expect some higher credit cost also?

Ramesh Iyer: I did not actually get your question.

Amit Ganatra: If I look at the disbursement breakup and if I look at the growth, the growth has come in tractors which is 38%, it is coming in used vehicles at 71%, and in the used vehicles you mentioned the yields are in the range of 22% to 25%, these yields are basically a reflection of the overall OpEx as well as credit cost that one would expect from?

Ramesh Iyer: I may just want to interrupt and correct you. For these products, the credit cost is not related to the interest cost at all. It is their ability to earn and repay it. It has nothing to do with the cost. For example, secondhand vehicle, historically the yields have always been that and the credit cost has never been high. The credit cost on the used vehicle comes from the secondhand price of the product when you transact, when you would repossess and sell those vehicles. Otherwise, it is a part of their overall buying price. Therefore, interest cost does not guide that. As far as tractor is concerned, again you will see historically, tractor credit loss comes from the ability to use it in farm and haulage, and therefore the related cash flow. The cost is always they can accommodate, any kind of price as far as tractor is concerned because ultimately if it is used in haulage they push up their local use price per hour, etc. and therefore we have never witnessed that an interest cost going up from 16% to 18% causes a credit loss higher. It is always the use of the product more frequently during the period of its existence and generates adequate cash flow to service alone to service the loan, and at the end of the day the resale priced getting protected if the sequence in which the credit loss actually comes in. So I do not think the worry is about interest cost going up will increase the credit loss, I do not think that is a worry we need to have.

Amit Ganatra: I am not talking about the interest cost going up, basically product mix changing in favor of used vehicles and tractors.

Ramesh Iyer: If you look at the overall balance sheet composition, even though tractor would have contributed I think 35% or whatever in the current disbursement, in the overall balance sheet composition you will find it is not more than 17% or 18% of the total balance sheet. It is only a timing. Tractor also has a season. As we go along, next three months there will not be as high as sale of tractor that we saw in the first three months. It will once more come back sometime in the month of November or December before harvest. So you will see it go up in one quarter, will come back down in the next quarter, which is how it averages itself to not more than x% of the balance sheet.

Amit Ganatra: Okay, I got it, thank you.

Moderator: Thank you. The next question is from the line of Parag Jariwala from Macquarie. Please go ahead.

Parag Jariwala: I just wanted to know from short-term sources of fund like mutual fund, etc. our contribution is slightly higher around 20% odd. I know that you have taken a lending rate hike of 50 to 80 basis points, but if this situation is going to continue, more hike in lending rate you are seeing to offset the cost increase?

Company Speaker: If you see the breakup of the liability side, we have roughly around 8% of our liability coming from the short-term source, which is around CP and usually if you track our liability profile for the last couple of years, during the first half we see that we try to optimize the cost by borrowing from the CP market, because that is the time when you can use the short-term papers, whereas in the second half you get the long-term papers from the banking segment which is the ideal time when you can negotiate best on the banking source for the longer period, and that is what the strategy we always follow and to that extent we have tried to use that as an intermediate tool for funding the asset by using the CP route, but I believe the mutual fund exposure whatever we have sourced in the current quarter is more towards the long term which is a 2-year nad 3-year paper, and not by way of short-term papers, so mutual fund exposure of 20% is not comprising the entire short term.

Parag Jariwala: Okay. If I have to assume that Rs. 100 we are borrowing in a year, what could be for less than one year?

Company Speaker: As a time bucket, maturity profile on a given cutoff date since our asset book is 36-month-tenure paper, and average maturity of book is 28 to 29 months, every year there will be a liability to the extent of around 30% to 35% maturing, depending on the past liability maturing. So one can fairly assume that our liability maturity of one-year paper will always be between 30% and 35%.

Parag Jariwala: Okay, thanks.

Moderator: Thank you. The next question is from the line of Vikesh Gandhi from Bank of America. Please go ahead.

Vikesh Gandhi: Congratulation on good set of numbers. I just wanted to get some overall guidance, you have spoken about overall volume growth and all, but are you seeing any kind of change in the repayment rates between the products and is it like very similar to past trends?

Ramesh Iyer: As I said, except in commercial vehicles, where we are definitely seeing that the cycles have increased while we are not a very significant player so maybe our experience on this comment is a limited comment, but I think more than the product it is the geographical impact which is what is witnessed. Like south is taking more time to repay than any other market today, and we do expect if we were to talk a little of end June and a little of beginning July, south has also started showing good positive sings, which is also witnessed from the tractor sales from these markets. So there is this cash flow which is returning back, but if you were to kind of talk restricted to the quarter itself, then I would think geography impact of south is higher than any other geography more than really product by product.

Vikesh Gandhi: Okay, thank you Sir and all the best.

Moderator: Thank you. The next question is from the line of Venkatesh Sanjeevi from ICICI Prudential. Please go ahead.

Venkatesh Sanjeevi: Is it a change in securitization accounting this quarter, can you just explain what has happened?

Company Speaker: Last year securitization accounting guidelines were released and as per the new accounting guidelines of the securitization, what we have to do is instead of accruing the income on an amortization basis, it speaks about cash basis accounting. What it means that, earlier whenever we used to do the securitization, we used to book the income on accrual basis over a period of the contract or over the period of the term of the securitization. As per the latest accounting guidelines, which was released last year, what we have to do is we have to first accrue the income of which we have to reduce the entire overdue which is built up in that portfolio including the principal which is fallen due, so that has to be netted up from this accrued income and only balance we have to book as the income, so that is the change which has come in last year accounting guidelines. For the fresh deals, whatever prospective deals we have done, that is from last year March onwards, all those will be accounted based on the cash basis.

Venkatesh Sanjeevi: What is the net impact of this change?

Company Speaker: In the current quarter, around 12 point some Crores we have reduced from our accrued income for the last year's deal.

Venkatesh Sanjeevi: So your PBT would have been more by 12 Crores?

Company Speaker: Had we followed the accrual basis.

Venkatesh Sanjeevi: My second question was on the OpEx side. How much of leeway do we have on OpEx because this quarter I see the OpEx has come down on a QoQ basis, it usually does not come down so much, so how much of discretionary part is there in OpEx, you can pull back in case if the business does not turn out to be as good as it is expected?

Ramesh Iyer: The range that we have seen that it can come down or go up, the range bound between 40 basis points and 25 basis points plus/minus, because each branch by itself is having a set of expense that they incur for conducting the business and recovery, and there are common expenses which are shared expenses like the head office, regional offices, etc. So one would clearly see that the range bound is only 25 to 40 basis points possibility.

Venkatesh Sanjeevi: So this quarter, for the lower OpEx is one of it or it is a conscious call to reduce?

Ramesh Iyer: I think it is the higher volume that gets generated from each branch, the productivity of the people. When you get into multiproduct, you get this benefit.

Venkatesh Sanjeevi: But the absolute OpEx being lower on a sequential basis?

Ramesh Iyer: Yes that will be, because if you see the volume growth of 30% odd and if you have not increased proportionate number of people, and therefore what is our OpEx virtually is people cost.

Company Speaker: Secondly, when we open branches and start hiring people, you can take between 3 and 3.5, 3 will be the lowest, around 3.5 will be highest, so I do not think we will have, because it is a physical model. You will not see a huge benefit in it.

Ramesh Iyer: One cannot expect it will go down to 2.5 or 2.25 and all that. You do not get the benefit of scale across the branch. Branch by branch you will get the benefit. Whichever branch is able to maximize it, it comes down and therefore on an overall basis that is why I use the term range bound between 25 and 40 basis points plus/minus.

Venkatesh Sanjeevi: My question was in Q4 FY'13, the OpEx was about 230 odd Crores, and Q1 it has come down to 200 odd Crores, so the absolute amount has come down.

Ramesh Iyer: Absolute amount maybe if there are some legal expenses, this and that, which would have been incurred in the last quarter, and there could be some higher volume, brokerage or acquisition cost which may go into that. There will be various items which may not necessarily be comparable between last quarter to first quarter. For example, there could have been some items like incentive programs for employee for the last quarter performance, which would have gone into last quarter provision, which may not happen in this first quarter, but it will come back in the third or fourth quarter.

Company Speaker: We can only tell you that in the fixed overheads, there is no significant reduction and there is no significant increase, it is all stable.

Ramesh Iyer: If at all any because of the variable expenses which have come in the last quarter, not necessarily continuing in the first quarter is the ones which would have dipped it.

Venkatesh Sanjeevi: This trend was seen last year between Q4 and Q1.

Ramesh Iyer: There could be some specific item like an incentive program announced for last quarter, some advertisement expense was there. There was some 6 Crores of advertisement expense in the last quarter of last year, which is not there in the first quarter of this year.

Venkatesh Sanjeevi: Okay, there is one off?

Ramesh Iyer: There is no model change in any new method of doing a business or any intervention of a new method which brings down the cost substantially lower, the answer is no.

Company Speaker: At the same time, there is no reason to think that the cost will go up also. More or less, the fixed costs will remain stable.

Venkatesh Sanjeevi: Okay, thanks so much.

Moderator: Thank you. The next question is from the line of Nikhil Rungta from Standard Chartered. Please go ahead.

Nikhil Rungta: I just wanted to check why there was such a huge growth in the preowned vehicle segment. Of course it is growing strongly and we know about the pickup in preowned cars and all, but still the growth was really very strong YoY and QoQ basis?

Ramesh Iyer: As we have been repeatedly saying that is one area of focus for us clearly. Second is very interestingly we got into car business let us say three years back, many of our own customers whose contract mature they sell vehicle so we get an automatic benefit of the source of the product going to the buyer of the product. Otherwise you have to search from the market, you cannot grow book like this. The car segment is growing in the rural market, where True Value, Mahindra First Choice, all the secondhand platforms have been setup. So the overall volume of secondhand vehicle in the rural market is also picking up and that is the benefit that we are getting. I think one third reason which is what the two-wheeler guys repeatedly keep saying that eventually a two-wheeler guy graduates to a four-wheeler through a secondhand vehicle. Then, the last of the item is as you recall, we have created a direct marketing vertical which actually reaches out to our existing customers and through them generate more business in that market. So the direct marketing is to actually benefit the new car sales in a geography not represented by so many dealers and generate secondhand vehicle demand of our existing customer planning to sell vehicle.

Nikhil Rungta: Okay, thank you so much Sir.

Moderator: Thank you. The next question is from the line of Kunal Shah from Edelweiss. Please go ahead.

Kunal Shah: Congratulations for good set of numbers. My question is on yields, if you look at it, in FY'11 the (indiscernible)42:09 contracts which we would have entered into, that would have been at a relatively lower yield, the overall tenure being three to four years and those would be still holding on, but as we go along say from FY'11 to FY'13, yields have moved by 100 to 150 basis points across the total segments, and the interest cost has also gone up. Considering that, should we see the yields stabilizing, even though there is steady change in mix because of the rundown of low yield contacted in FY'11?

Ramesh Iyer: I think I would say yes and no, both. Yes, from the point of view of the way you explain the breakup of the product, but if the borrowing cost is to go up, as I just told you we have pushed up our lending rate, to that extent the impact of yield you can see it will move up, but you should not see it in isolation to say when we keep increasing the lending rate and therefore will the yield keep moving up. It is the product mix change comes in, like tractors are now doing better. So tractors are always at a high yield. If you look at just this quarter, next quarter, one may see yields going up because of the tractor business, but if that settles down and car business picks up then you will see yields kind of coming off. I think what we clearly measure is for each of this product, we have fixed certain yield based on the operating cost of this product and the credit loss of this product, which has to give a net return for sure. While we will ensure that those kinds of rates are used for lending purposes, on a summarized basis one would see a little movement of yield going up or down based on these two to three factors that I have mentioned. Otherwise, if you historically look at, we are a range bound company, you will not see yields dropping very significantly or shooting up very very significantly.

Kunal Shah: So it should settle in a narrow band.

Ramesh Iyer: I think so, because we do not see too much of change in our product mix as far as the balance sheet is concerned.

Kunal Shah: Because if you look at last three years, structural yields have been coming up, so that would be some securitization impact and some on account of the product mix change?

Ramesh Iyer: Yes, clearly commercial vehicle when we got in they are a low-yield products, now that we are out of that business, if it is replaced by tractors and some secondhand vehicles and some cars, one would see an improvement happening around that time.

Kunal Shah: In terms of what we highlighted during the last analyst meet was it to offer all the products from all the locations to every profile of the customers, would that not help in bringing about some flexibility in the operating expenses as well?

Ramesh Iyer: Let me clarify, when we say all products from all, there are certain products which do not require to be operated from 700 branches, only eligible product and eligible location. I think, the volume has a variability to the number of people and the cost that is required to be incurred from that branch, so the only benefit that you can get if you offer all products from all branches will be the branch expense by itself, which is little, the rent and those kinds of costs. Otherwise what is our next OpEx cost is all people cost. If you keep increasing number of customers from a branch, the number of people managing the customers will keep going up. Head office expenses, regional office expenses, and the branch infrastructure expenses are the only one which gets divided by the volume and therefore it may look to come down as the volume goes up. Otherwise, most of it is a variable item.

Kunal Shah: Okay Sir, thanks a lot.

Moderator: Thank you. The next question is from the line of Umang Shah from CIMB. Please go ahead.

Umang Shah: Thank you for taking my question, I just have a couple of them. One is related to the preowned and the refinanced segment, if you could just break it up how much of it would be refinanced that is to existing customers?

Ramesh Iyer: When we use the term refinance, it means that financing on the vehicle for acquisition. So it is not top-up loan to existing customer, if that is what you meant by existing customer.

Umang Shah: So let us say an existing customer whose contract is maturing and if he goes in for another vehicle, so it gets classified as a new loan altogether.

Ramesh Iyer: Yes. If he buys another vehicle, anyway it is a new loan. If this vehicle he sells it to somebody we call it as refinancing, instead of calling it preowned, we call it refinance.

Umang Shah: Okay, is it fair to assume it is more like a transfer of loan?

Ramesh Iyer: No transfer, only if the first loan is over, if he wants to sell the vehicle then only new loan. There is no transfer of loan, there is no top-up loan.

Company Speaker: Normally, since we know the customer, he is selling his vehicle to a buyer, he tells the buyer Mahindra Finance gives loan, if you are interested you go and meet them. The customer acts as a referral point, so the customer has nothing to do with the new borrower, he does not know him, he just gives him information that Mahindra Finance normally finances. So that new buyer comes to Mahindra Finance, I am purchasing so and so vehicle, are you interested in giving me money. There is no connection whatsoever, the refinance and all is normal colloquial word we use. It is a fresh finance to a fresh customer for a vehicle which one of our customers was owning in the past. It is a secondhand vehicle sale that we finance. This portion is also part of the total used vehicle portfolio, because many of the vehicles which we finance is used vehicle is also sold through this organized franchisee which is True Value, First Choice and all that. It is like any other new dealer showroom.

Ramesh Iyer: You must be clear that it is not an assignment of loan to another customer.

Umang Shah: I understood. Across products, do we do any kind of working capital loans, something like tyre financing?

Ramesh Iyer: No, we are not yet into all that. We have enough of assets to be financed already.

Umang Shah: Just one last question, in the past two weeks we have seen a couple of measures coming from the RBI side and obviously the impact of that is seen in terms of liquidity and short-term wholesale borrowings. Could you share your experience whether you guys have done any kind of borrowing of late and in terms of discussion from your bankers, what kind of rates of expected if you were to borrow from the banks in the near future, the terms remain the same or the spread over the base rates are likely to change?

Company Speaker: As far as post the regulatory announcement, short-term rates have spiked in the market, so far we have not gone to the market for raising the short-term paper, which is usually we use during the first of CP route. You must be knowing that CP market has gone up by around 300 basis points in the current scenario. So we have not gone to the market and raised any money in the last 10 days or so. Going forward, whenever there is a liability maturing, we believe that we have an adequate line from the banking segment, which is available at a base rate and most of the banks are willing to offer at a base rate even today, except for some of the private foreign banks where their treasury is not able to quote in the current dynamics this pricing. So I think we will have to wait till the market cools up from the private or the foreign banks. As far as the public sector bank is concerned, we continue to get this kind of base rate borrowing paper even in the shorter tenure. Yes, their base rate itself is high so to that extent the pricing of the short-term paper will go up to that extent, but I believe that this will be a short situation and it should get settled somewhere once the RBI makes an announcement in the policy on 30th July which will be more directional I believe. Of course what announcement RBI makes, we will have to wait, but I think that will give us a clear market indication as to what the market will be. Even today when we were discussing with the banking segment for the longer duration term loan, we are able to negotiate at the similar terms.

Umang Shah: I understand, that is quite insightful, just one last data point, within overall tractors what would be the proportion of non M&M tractors on the outstanding book?

Ramesh Iyer: Very small. When we say Mahindra, it also means Swaraj, which is also a Mahindra brand, so I would think 90% plus will be Mahindra and Swaraj. We just started the other products not too far off, so it was just about last six to eight-month storey.

Umang Shah: Okay, even in terms of incremental disbursements, the numbers would not be much large.

Ramesh Iyer: It will not be, at the end of the day, we are only maximizing our reach and getting the volumes that we can through our direct marketing initiative. We do not really go to a dealer and ask for too many business because we do not want to be addressing their concern of us converting non Mahindra to a Mahindra product.

Umang Shah: I understood, thank you so much Sir. That is all from my side.

Moderator: Thank you. The next question is from the line of Manish Shukla from Madhuchanda Dey. Please go ahead.

Manish Shukla: Good afternoon Sir. The AUM growth of about 35%, considering that there has largely been discount in vehicles across the board over the last one year, is it fair to assume that almost the entire AUM growth is volume and not inflation?

Ramesh Iyer: 27% is volume. If you look at tractor and refinance which is the growth segment, the last year first quarter was a subdued segment, so they are really not comparable in the form of a discount per se, discounts are largely in cars. So one can possibly say car is volume because of multimanufacturer introduction by us and the value comes from subdued segment of the past like the tractors, refinance, etc.

Manish Shukla: In the cars and other segment, how much is cars and how much is other, of the AUM 33% is car and others?

Ramesh Iyer: 24% is car.

Manish Shukla: In any of the products that you finance, is there any arrangement with manufacturers today wherein they offer some kind of a backup or guarantee for the lending that you do?

Ramesh Iyer: Guarantee for lending we will not have for the product, but we get subvention for most of the them or many of them, but we keep on and off negotiating, the choice is to discontinue a product if we see some kind of a crack, because we are not too very comfortable in the sense of taking guarantee and doing a business because then credit sacrifice can happen at the branch level. So we would rather give up the business rather than taking a credit backup and if at all we find that we incur a loss in a product, we actually are able to negotiate even if we do not have a formal agreement. We are able to negotiate for a loss protection if they want us to continue to support.

Manish Shukla: Is there any such arrangement with M&M?

Ramesh Iyer: We do not have a written agreement, we used to have long time back, now we are negotiating for their truck business, if they want us to participate in the truck financing then we are saying that our experience needs to be considered for the loss protection.

Company Speaker: Anything unusual, we go back. If it is something of normal credit loss that we have to bear.

Ramesh Iyer: The discomfort that we have when we ask for a credit support, they will also then request you to drop your lending rate for such customer. Because they will otherwise say that the customer possibly is going bad because of so and so reason. They may then ask us to consider certain profile of customers which we may not want to consider. We will avoid taking credit losses as a support for growth. We would like to give up some volumes at the cost of quality, we do not want to add volume and get into quality issues.

Manish Shukla: Okay. Just one last question, I do appreciate that there is some element of seasonality in your asset quality and it generally tends to improve during the course of the year, but I was just wondering that with the amount of technology adoption and MIS that you have, is it not possible to at least reduce this level of volatility as we go on because volatility today is still almost same as it was let us say three or five years back as far as Q1 or Q4 is concerned?

Ramesh Iyer: I think it is nothing to do with our ability. It is everything to do with customers' ability and cash flow. One must understand that rural cash flow is patterned that way. It is not that we collect zero money in the first half and all the money in the second half. Businesses which are dependent on rural cash flow will behave that way. We do not say this for cars which are used for personal level. We do not say this for three wheeler which are used for people carrying, but we for sure say this for tractors, we for sure say this for commercial LCVs, commercial vehicles, so products which have a seasonality nature of cash flow, it is not the technology or our MIS or our reach, I mean that way why technology we are present in every location physically. So it is not our ability or our understanding or our method of changing a pattern, it is the cash flow pattern.

Umang Shah: Okay, right Sir, those were all my questions. Thank you.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question. I would now like to hand the floor back to Mr. Uberoi for closing comments. Please go ahead.

Karan Singh Uberoi: On behalf of JM Financial, I would like to thank Mr. Ramesh Iyer and the entire senior management team of Mahindra and Mahindra Financial Services, and all the participants for joining us on the call today. Thank you and good bye.

Moderator: Thank you gentlemen of the management and Mr. Uberoi. Ladies and gentlemen, on behalf of JM Financial, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.