"Mahindra & Mahindra Financial Services Limited Q1 FY '19 Results Conference Call"

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MANAGEMENT: **MR. RAMESH IYER – VICE CHAIRMAN AND MANAGING DIRECTOR**

MR. V. RAVI – EXECUTIVE DIRECTOR & CHIEF FINANCIAL OFFICER

MR. ANUJ MEHRA – MANAGING DIRECTOR, MAHINDRA RURAL HOUSING FINANCE LIMITED

MR. RAJNISH AGARWAL – SENIOR VICE PRESIDENT (OPERATIONS)

MR. DINESH PRAJAPATI – SENIOR VICE PRESIDENT (TREASURY & CORPORATE AFFAIRS)

MR. RAJESH VASUDEVAN – SENIOR VICE PRESIDENT (ACCOUNTS)

MR. VISHAL AGARWAL – DEPUTY GENERAL MANAGER (TREASURY & INVESTOR RELATIONS)

MODERATOR: **MS. BUNNY BABJEE – RESEARCH ANALYST, JM FINANCIAL**

Moderator: Good Day Ladies and Gentlemen and a very warm Welcome to the Q1 FY '19 Results Conference Call of Mahindra & Mahindra Financial Services Limited hosted by JM Financial. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Bunny Babjee from JM Financial. Thank you and over to you, Madam.

Bunny Babjee: Thank you. Good Morning everybody and Welcome to Mahindra & Mahindra Financial Services Limited earnings call to discuss the first quarter FY '19 results. To discuss the results, we have on the call Mr. Ramesh Iyer – Vice Chairman and Managing Director; Mr. V. Ravi – ED and CFO; Mr. Dinesh Prajapati – Senior Vice President (Treasury & Corporate Affairs); and Mr. Vishal Agarwal – Deputy General Manager (Treasury & Investor Relations). May I request Mr. Ramesh Iyer to take us through the financial highlights subsequent to which we can open the floor for Q&A. Over to you, Sir.

Ramesh Iyer: Good Afternoon everyone, so we had I would think fairly a good quarter from where we were and that we have been saying all through the previous year into this quarter, that we do see the sentiments at the rural geography improving and improving at the back of two things, one, the monsoon has been on-time, it has been widespread, and therefore, the expected monsoon as we close the season is expected to be above average, definitely is one positive sentiment from where the rural population is operating. Also, we clearly look at from the infra perspective while different states have different level of activity that we witness, but we do see activities from state, from the district, as well as from the municipality driving activities at different state that has also been the other benefit for rural. Kind of look at the two streams of cash flow, therefore which is the farm and the infra cash flow seems to be definitely benefiting a company like ours, which are so very rural focused. I think the benefit of having set up penetration in the fourth quarter about 100 odd branches that we opened also is one of the reasons that we seem to get the benefit of volumes from this market. As we have always been saying, every OEM from the car segment has reached out to this market and we do have a significant role to play in terms of growing our business.

Our growth drivers for the quarter particularly has been coming from pre-owned vehicles, it has been coming from commercial vehicle growth apart from the fact that we have been gaining market share in our prime products like auto, tractors, Maruti segment, and has helped us gain market share and that has been the other reason for our growth very clearly. As far as the competition is concerned, we yet do not see too much of competition around and clearly banks going a little slow on the retail front has clearly been an advantage in our favor and that has helped us gain volumes from this market. It is also important at this stage to understand that we do see the borrowing cost moving upward and our own forecast for the year is that it will inch up a little further, but it also allows us in that market not to be under the pressure of these margin and we have been able to pass on to some extent the price borrowing cost increase to the consumer and our belief has always been that once we hit the 25-50 basis point increase, we would try and pass it on to the consumer. Yes, we will be selective and not doing it across the board for all product, all geography, but to a larger extent would get covered, but the product mix also will have an ability to protect our yield, and therefore, we do not yet see any pressure on the margin is concerned.

For the first time, I would think after a very, very long time in the history of MMFSL where we have seen the increase in gross NPA from the fourth quarter to first quarter been at its lowest ever. Normally, one would witness a gross NPA increase and I am more speaking from the earlier accounting methods while the new IndAS will be explained by Dinesh or Rajesh, or Ravi or anyone, but clearly from a gross NPA in the past we have seen from March to June, normally there is an increase of 2% to 2.5% or may be upwards in terms of NPA or even for that matter number of accounts moving up as NPA has been upward of 45,000-50,000 accounts whereas in this quarter, it has been one of the lowest that we have seen and that is a good start point from our perspective because normally the first and second quarters are not the best quarters for rural. In fact, the third and fourth quarter are the ones which help and this given the direction and if third and fourth quarter turns out to be the way we look at it, I think we would see improvement to the asset quality going here onwards.

Similarly, on the growth front as I said gaining of market share for our prime product like auto, tractors or even for that matter Maruti cars are a good sign from our point of view because that puts us in a position of gaining volumes from the prime volume that these businesses do and then getting into new product becomes an add on. Given the current inventory levels of the market, I think the discounts are still continuing and we think by the festival season some of the discounts must come off and as the discounts come off for the same volume, the value of growth would be even better. I think from overall perspective, the disbursements have grown, the asset book has grown, the NPA position for us has remained stable as we think, and therefore, the profitability has grown further and the margins are protected with not too much of competition around and the price increase to the consumer is being possible from our point of view.

Our one area of concern from the subsidiary perspective remains to be the rural housing subsidiary where we have seen the increase in NPA and it is also caused by the new accounting method, but even otherwise the base NPA numbers are high and they are caused largely by geography like Maharashtra where the cooperative banks participation after demon- has been much lower and the consumers have resorted to possibly using our installments for their basic requirements of seed, fertilizers, etc. and our belief is that in the next two quarters, correction from this would be much faster than it has ever been seen, but the margins are well protected even in that business, the growth is pretty high in that business, and therefore, reversal of NPA from where we are today will be a good add on to improve the return on equity of that business as we look at it. Otherwise, from the main business of Mahindra Finance, the asset quality improvement is every quarter that we have seen and we continue to believe they will only improve further going forward, so the worst is over for us from that market and we feel very comfortable and confident of maintaining the growth.

We had said in the past maintaining 15% to 20% growth would not be a major challenge and I think we have hit that number already and we believe that our stance continues to be that we would look at growth, we would look at deeper penetration, we would look at margin protection even if it means to revise certain lending rates and we are adequately capitalized and resources well tied up for us to be able to embark on that growth story, so overall tone of what we think going forward from here will be a decent growth story for us with asset quality improving even better than where we are at this stage as we look at the future and maintaining the margin and maintaining profitability, and therefore, coming back to the ROA levels of between 2% and 3% that we always looked at is something doable in the next three quarters as we cross the bridge is what I would think will be the overall summary. As I said, rural housing will focus on this one geography where the NPAs are substantially high and they would get corrected in the next couple of quarters to see the growth of that business as well.

So far as insurance business is concerned, they have had a growth of 10%-11%, but they have been few regulatory changes on and off that has been coming in and that is causing a little pressure on their profitability, otherwise, the volumes of that business has been pretty good. They are well synergized with our business and now that the regulatory framework is decently settled, one would also see a growth of that business happening. I think, overall summary of therefore our approach would be that semi-urban, rural is buoyant at the back of good monsoon, at the back of improved infrastructure, and the onset of elections in major states leading into the country election will be a good story to watch for from a rural perspective and we have seen in the past, these are triggers which drive cash flows in that market and we are well-positioned to take complete benefit of it. Our relationship with all the OEMs helping us grow business is the other strategic intent with which we are driving. Deeper penetration with opening up of more branches is the other approach. We have adequately invested in our digital and analytics approach and the benefits of that would also be seen in the coming quarters with some businesses getting transacted, the cost getting curtailed and controlled through that approach and using analytics to forecast trend and prepare ourselves both in terms of either launching products or handling the business that we have already done or even to that extent guiding and training teams based on those trends will be where we would use all these data analytics approaches, but as otherwise we believe that the worst is over from last one year we have seen it and that has flown into even this quarter and that is our belief as we go along. I would request Dinesh or Rajesh to also quickly tell you the difference between the Indian GAAP and IndAS accounting, so that when you raise questions, you would have clarifications on what are the gaps.

Dinesh Prajapati: As far as we have migrated to the IndAS accounting standard from April 1, 2017, which is why our reporting has been in this quarter based on the IndAS. We have given our reconciliation in our presentation if you had an opportunity to go through the presentation. For our April 1 migration, we have given a reconciliation. At the same time for the first quarter of this year financial reporting, we have given the reconciliation in our presentation Slide #29 for all quarters June '18, quarter June '17, and for the full year March '18, so any specific query on that we would be happy to take the questions on it and in case if it is required a detailed explanation then we can take off-line discussion on the subject separately. Even the derived book value as of April 1, 2017, based on IGAAP versus based on IndAS has been re-derived based on the IndAS profitability. As far as the June 30, 2018, the book value is including the dividend value which is based on in the new accounting standard is based on cash accounting, which will get netted off once the cash flow is credited to the shareholder. Thereafter, the revised book value will be derived.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Mahrukh Adajania from IDFC Securities Limited. Please go ahead.

Mahrukh Adajania: Just wanted to check if you could share the PDs on Stage-1, Stage-2, Stage-3?

V. Ravi: Roughly, the first is something like about 1.2% for the Stage-1.

Ramesh Iyer: All over a period of time as the year progresses, but I think if you want to look at the standard provision was 0.4 as against that it would be something like 1.2 or so and in the second bucket, it would be about 12% to 14% gap instead of 0.4 and when the last bucket is around 27%, while the coverage is 35% as against our normal coverage which used to be 50%, but if you look at Bucket 1, 2, and 3 to the extent of the total provision made and then you look at it as a coverage instead of 50%, we would have about 58% coverage, but the PD evolvement I think you must give us another quarter or two, as we come to the year-end we will know because we can relook at the whole happenings during the year before we kind of tell you this is exactly what it is, but our own understanding and approach may be you can reach out to Dinesh or someone who can give you a little more explanation, but largely I think this is the way to look at it, so standard 0.4 has moved up to 1.4 in the first stage and then it has moved to something like 12 to 14 in the second bucket, and then the coverage has gone to 35% in the Bucket 3 with LGD of about 27%-28%.

Mahrukh Adajania: My other question was can you share your thoughts on the Axle norms, I know you are not very, very-very big CV financier, but your CV portfolio is growing well, so your thoughts on the new Axle norms?

Ramesh Iyer: One is I think we should understand the Axle norms are applicable to some specific range of vehicle and it is not across the board all vehicle etc., that is one. Two, it is more an OEM problem than a financier's problem for simple reason that we would finance the vehicle they sell. If they sell less of this vehicle, so be it, that is not a problem for us, but OEMs are putting their heads together to say how they are going to counter this. If at all any concern from our point of view and if that concern is really true which is that even the old vehicles are allowed this kind of an official overloading, they seem to prescribe that technically those vehicles are not as competent to carry that load, but parallely we read some statement that those vehicles were anyway carrying that load, but if you were to go by a very honest opinion that they are not carrying those load and now they will carry excess load, then is there going to be more accidents on the road, will more vehicle come up for these kind of claims, so it is an insurance company worry as far as we are concerned, but will this vehicle really earn better to repay better installment, but will they wear out much faster than they were wearing out before, so if you have to repossess some vehicle after they have been not so well used, will there be some drop of resale price, but these are all very, very imaginatory without exactly knowing which will affect how many vehicles etc. I would think that we should wait for OEMs response eventually as to how they are handling it, but as otherwise the market seems to be slowly settling down to say okay, the new vehicles will come with new norms and that is what would get accepted, but otherwise for the financer it is not top of the mind worry at this stage.

Moderator: Thank you. The next question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question on the growth side, in this quarter we grew our AUM at 21% YOY and against our guidance of 15% to 20%, so would you increase your guidance or you stick to the 15% to 20%?

Ramesh Iyer: I think you must give credit to us saying that we said 20 and we did 21, right, so 1% is not something we can have our judgment on. I mean if I say our growth is going to be 18 to 22 is that a revision enough, I do not know. The way you must look at when we make this judgment on 15 to 20 could end up at 25, could end up at 14. What is we all guided by, I think it is all guided by what is the overall number OEMs are clocking about, what is the OEM competition at the marketplace, what is the competitive scenario for us. For example, when we said 15 to 20, we did expect that some of these banks will continue to remain a little aggressive, but for good reasons that the banks have gone a little slow, so we got the benefit of that. Now, do we want to based on that say we will grow at 30% to 35%, I think that is not what we want this year. I think what we are generally trying to say that trigger seems to be a growth story rather than a standstill story, so we were worried at 8% to 10% growth in the previous year, we revised it to say 15 odd percent for the new year and then we are continuing to say that the growth trigger seems to be around 15% to 20%. Tomorrow, if discounts vanish or for that matter all OEMs announce price increase, for the same volume we can get another 2% to 3%, growth, so will go to 25%. Please look at aspect of price increase to vehicle, multiple product reaching out do that market and getting us some volume benefit, gaining of little market share that happens to our prime product, and growing of businesses like pre-owned vehicle, commercial vehicle where our base in the previous year was a little low. Add the four together, I think the statement we are making is growing at 15% to 20% for the year does not seem to be a challenge.

Manish Oswal: Second question Sir, on the mix of the AUMs and impact of the net interest margin profile of the company, so do you expect because of the changing of the mix, we are growing on the CV book side aggressively so that could have some impact on the margin profile?

Ramesh Iyer: Net interest margins may look a little compressed because of the lending rates are different, but surely the cost of operation and NPA of those products are also expected to be much lower, so at an ROA level is that a pressure, my answer is no. At net interest margin level, it may look to be that, but simultaneously also look at our pre-owned vehicle is also going aggressively, so that also brings in an improved margin, but for sure on an overall yield basis when you look at will our 18% yield start looking like something like 16%, the answer seems to be yes, and therefore instead of 9% margin will it look like an 8% margin, the answer seems to yes, but at the same time you are also seeing continuous reduction to the cost of operations and the NPA reduction, and therefore, ROA protection will happen.

Manish Oswal: Last question on the gross stage NPA number of 9.4%, you said in your comment that the quality will further improve in the coming quarters and you give the guidance of 2.3% to 2.4% ROA, the question is of two-part, one is both the housing subsidiary, asset quality, and the vehicle finance asset quality, what kind of improvement we can expect because the housing finance subsidiary numbers are much worse than the standalone vehicle business?

Ramesh Iyer: Housing finance I just said right at the beginning that it is caused more by one geography in Maharashtra where we have problems arising out of the little drag from the cooperative banking system in the past where the consumers therefore were resorted to use their money for their own requirement of buying of seeds and fertilizers instead of taking a loan from the cooperative bank. Clearly, that would get corrected and they would get corrected faster than one can expect to get corrected. So far as the vehicle business is concerned as I said, this is the first time in the first quarter we have seen stabilizing of an NPA instead of growing of an NPA and that once leads into the third and fourth quarter which is really the good cash flow quarter. Historically, we have corrected our NPA in third and fourth quarter. If similar correction had to happen in third and fourth quarter, we would see a very different number from where we are at this stage.

Manish Oswal: Just to add this thing since in this quarter the deterioration is very less, so can we expect the correction will be much higher?

Ramesh Iyer: So that is exactly what I am saying, I do not want to put a number to it, but if you were 10.5% gross NPA in June last year which ended up by 7.1% or 7.4% as of March, and therefore, if we are starting at a different number and we expect a similar correction to happen, the end number would look different.

Moderator: Thank you. The next question is from the line of Rahil Shah from Ambit Capital. Please go ahead.

Rahil Shah: Sir, I was just trying to understand how the credit cost is impacting the P&L, it is like under IndAS, so your gross NPA has improved significantly on a YOY basis, however, your provisioning cost has doubled, so like 130% up on a YOY basis, so can you explain what has led to this steep rise despite improvement in asset quality?

Ramesh Iyer: Stage-1 and Stage-2, standard provisioning was 0.4 in Stage-1 and Stage-2 whatever you call it then and that has jumped up to almost 1.4% for the first stage and something like 14% for the second stage.

V. Ravi: The corresponding quarter this is understated because April 1, 2017, transitionally it was adjusted in reserves, so opening balance adjustment of the earlier corresponding year and this year as well as last year the Stage-1 and Stage-2 is substantially more than what it would have been in Indian GAAP, so these two are the major reasons, otherwise in terms of coverage you can see that it has not come down even below the March level and in fact the coverage has gone up as compared to the Indian GAAP so everything the point here is that the coverage is indirectly increasing it showing it that the provision is mainly goes for coverage not for any deterioration, so this is clearly I would say much more conservative than what we were in Indian GAAP.

Rahil Shah: Okay, so just to clarify for the 1Q FY '18 number and as per IndAS, the provisioning cost was around 127 crores, so the additional impact has been adjusted in the opening reserve, so this 127 crores is kind of understated?

V. Ravi: I am talking of April 1, 2017, transition.

Rahil Shah: So before that everything must have been adjusted in opening net.

V. Ravi: Yes.

Rahil Shah: But in 1Q, so your gross NPA has increased from FY '17 to 1Q FY '18, so ideally under IndAS, the provisioning should have been higher than 127 crores, I am just trying to understand why it is lower in 1Q FY '18?

Ramesh Iyer: If you look at the first quarter of last year maybe the first and second bucket assets are higher than third bucket assets, so therefore, the percentage compared to third bucket will always be lower and then you come to this quarter, it is caused again by first and second bucket where the percentage is much higher than the standard asset percentage of 0.4% whereas gross NPA has come down in the third bucket.

Dinesh Prajapati: If you see the opening reserve as of April 1, 2017, the reconciliation will take care of this query because it is a cumulative reserve charge which is getting created, so effectively for the quarter P&L, it is a difference between that so we will explain to you off-line.

Rahil Shah: Another question on IndAS, I am referring to Slide #29 wherein you have mentioned impact of income accrued on Stage-3 assets for FY '18 it is negative 350 crores, so I am just trying to understand that under IGAAP earlier provisioning we were anyways not booking income on NPAs, but under IndAS ideally you can book interest income, so it should have been positive amount, so why it is negative?

Dinesh Prajapati: If you see again there is a link to the opening reconciliation of April 1, 2017. If you see the Slide #28, in that if you see the first line item and adopting EIR on financial assets and financial liability, there is a positive carry of 1451 crores which is having an income recognition because when you move to the IndAS, there is income recognition which is already factored in this for the entire balance sheet of NPL. Now, when it starts reducing in the next following year, the income which is recognized will start slowing down, so to that extent the gap will build and that is how, unless and until my NPL moves up, this will start keep coming down, so that is how it is and since in IndAS, what was reflected in the first quarter of last year it would have already factored in April 1, 2017, that is why the gap.

V. Ravi: You are seeing it -352 crores, you see the gap narrows between IndAS and Indian GAAP as we start moving the NPA assets become standard assets, that is all, you read this way because in IndAS, the NPA assets also unless it is Stage-3, there you can recognize income, so in the Stage-1 and Stage-2 you can recognize income that is why when we start improving the quality as compared to the past, the gap narrows so you see that, rather than minus do not see it as a minus see it as the benefit what we got due to IndAS movement in our income on NPA assets starts coming down because it has become more and more, the asset quality changes to the better.

Rahil Shah: Last question from my side, Sir, what would be your UV book from M&M vehicle like disbursement share of M&M vehicle?

V. Ravi: 43% to 45%, those numbers will not change. That we have shared in our breakdown of AUMs, Slide 20.

Rahil Shah: No, I am not talking about the share of UV, I am just talking about of total which you would disburse UV loans, what would be the share of our parent company vehicles?

Ramesh Iyer: UVs book of ours 80% will be M&M and 20% will be others.

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

Kunal Shah: Firstly in terms of the loss given default, that we have assumed it to be 35%, that is correct?

Dinesh Prajapati: As a cover, it is 35%. As we explained earlier also, the Loss Given Default is also a factor of the ED, which is Exposure at Default position and the Exposure at Default position is defined as first time when the customer or a contract moves into 90-day bucket, so on a reporting day if the customer has moved into 90-day bucket say earlier period or earlier year, it starts from that day, so it requires a calculation based on fair value basis and that is how the Exposure at Default is possibly it will vary for each customer or each contract on a different date, so LGD will remain static, but this particular difference between the LGD and the gap of these Exposure at Default and the day of reporting, there could be income recognition which is what is built in the coverage of 35%.

Kunal Shah: Okay, so that is also getting build, but otherwise in terms of purely when we look at it the Loss Given Default for the portfolio, how much should we ideally take in terms of this entire ECL framework?

Dinesh Prajapati: So it will keep evolving, at this point of time it is around 27% to 28%.

Kunal Shah: Secondly, in terms of this entire interest, so we had this discussion earlier as well, but when we look at the interest accrual on the Stage-3 assets, so when we look at FY '18 that is almost like 350 odd crores, which is offsetting the impact of the ECL, so how to rate this 350, when we look at the Stage-3 assets which would have been say the incremental delta which would have been there between FY '17 when we had taken the hit on the net worth and FY '18 end, what would be the EIR on this when we are taking this income accrued, would it be like 4% or 5%, how much should we take it?

Dinesh Prajapati: Kunal, what I would do is again it requires slightly more detail explanation, so we can take this offline for discussion.

Kunal Shah: Overall in terms of the outlook, maybe definitely in terms of the growth it has been much better this quarter and in terms of the outlook also it seems to be positive, but looking at the events which have happened maybe like we would have expected a slightly higher number and maybe because of this Axle norms and the other things, do we see some moderation because in the overall outlook when we look at it, the growths are getting revised downward for most of the vehicle sales, so how are we looking at it, is it like getting revised downward by 2%-3% or we are equally positive as far as like rural is concerned?

Ramesh Iyer: We are pretty positive because I do not know who is looking at taking it down, commercial vehicle, axle impact is one impact, but as otherwise I think the overall numbers are pretty decent and I do not think at least for us in the rural, we do not see the competitive intensity to be so high to relook at the number. If any, I would think the nationalized banks are a little slow, so one would get some benefit of that, so I think we are okay to the numbers we are not looking it downwards.

Kunal Shah: Lastly, in terms of we highlighted that quarter on quarter GNPLs would have moved up only by 70 odd basis points under IGAAP as well, but when we look at it in terms of the contracts under NPL, in fact there is still like 1.5% increase from 6.4% to 7.9% March to now?

Ramesh Iyer: There is one quick clarification, in March we move some of the contracts to bad debts and we would have moved I guess about 15,000 to 18,000 contracts to bad debts in March, so therefore, the March looks corrected, so if we were to adjust let us say in this quarter which contracts move to 100% provided bad debts, then the gap would still remain the same.

Kunal Shah: Okay, so it is not like 20% increase in…?

Ramesh Iyer: No.

Moderator: Thank you. The next question is from the line of Nidhesh Jain from Investec. Please go ahead.

Nidhesh Jain: Sir, on the provisioning if we just compare IndAS numbers for this quarter versus last quarter, is there any change in Stage-1 and Stage-2 provisioning percentages versus Q1 FY '18 and Q1 FY '19?

Dinesh Prajapati: Last year June '17, since it was 120 day recognition norm in the IGAAP and now since everything is IndAS reported number, you will see that percentage provision on the Stage-1 and Stage-2 lower in the June '17 number, primarily because there could be a shift in the bucket because of 120 day recognition if I recognize on 90-day basis many of these contracts would move into the 90-day bucket at Stage-3, so if you see that gross NPA Stage-3 for June '17 reported number is slightly higher compared to the trend and which is why if you see there is a gap.

V. Ravi: The Loss Given Default ratio has come down from 29% to 27%, 2% benefit we have got.

Nidhesh Jain: But probability of default have remained same especially under Stage-2 for us at the end of Q1 FY '18 versus Q1 FY '19?

Dinesh Prajapati: Probably of default would also vary, see it will vary because, this is a moving information so based on historical data, so I think that will also vary based on the data, so effectively annually once it is going to be revised, every March it will change.

Nidhesh Jain: If we look at the provision the credit cost line item just on IndAS basis, though your asset quality has improved substantially on a sequential basis, which was not the case last year, usually cost hit to the P&L has actually gone up, so I am just trying to understand the superior connection that we are witnessing right now, when it will get factored into your profitability, so it will factor in profitability by the end of the year, which is Q4 FY '19?

Ramesh Iyer: You are talking of overall provision to the P&L, right?

Nidhesh Jain: Absolute amount of provision to P&L.

Ramesh Iyer: One is if the book size is different, Stage-1, Stage-2 brings in that much more provision straight away, so you look at the book size because earlier book size was X it has grown by 20% supposing and then most of them are in let us say Stage-1 and Stage-2, so that is straight away additional provision in excess of what otherwise we would have provided only for NPA.

Dinesh Prajapati: Let me explain it this way since in the earlier regime, provision was made only on 90 plus dpd. In the IndAS, since you are going to provide on Stage-1, Stage-2 which is up to 90 days and in our case it is already the sizeable always because of the proportion of the book which is going to slide into Stage-2 on which I have to still apply the PD into the LGD, so that ratio is high, which is why if you see that provision will continue to remain high on that basis, and since we have now taken hit in the current by transition, going forward it is likely to be much more stable.

Nidhesh Jain: Historically, we have seen 30% to 40% decline in gross NPA from Q1 to Q4 in percentage terms, since we are now starting at a very relatively low number, do we expect similar decline or should we expect lower decline or higher decline given the environment, how should one look at it?

Ramesh Iyer: You should generally consider that third and fourth quarter will be definitely better than first and second, you call it 40, 50, 30, I do not think we can put a number to it, but surely third and fourth quarter for the last 20 years has been our best quarter, unless you see something very dramatically happens in the country suppose election gets announced in the third quarter, things can be very different. Even normal situation, monsoon being good given normal situation does the states have infrastructure story, therefore the harvest will come, the crop will come definitely the support prices are average plus, the cash flows of rural would be better in third and fourth quarter.

V. Ravi: Earlier, the income reversal was happening on NPA rule based of RBI and then when the NPA used to become a good asset, the income reversal used to be taken into consideration. Now, that type of things will not happen, so you will not have a very, very tectonic shift happening, but what will happen is that the resetting benefit can happen because the trend seems to be positive, rural cash flow seems to be improving, all this will result in expectation of lower loss going forward which will be reflected in correcting the resetting the rate, both probability and Loss Given Default in every March, probably what we can look forward to is a correction in these rates for the better in March '19, so you will get some benefit out of that, otherwise, the kind of anomaly which because Stage-1, Stage-2 growth so that will have a higher provisioning, those things will continue.

Ramesh Iyer: The other thing to look at it is in contract move from Stage-2 to Stage-3, we may not have to provide 22% because we would have provided 14% in Stage-2 level, so the net increase arising out of contracts moving forward will also be lower.

Nidhesh Jain: The P&L volatility will go down substantially?

V. Ravi: That is the whole idea, we will converge towards the actual loss over a period of time since we just migrated, it will take about 1 to 1.5 years to mature and settle down. Thereafter, in matured portfolio what you will see without much of an incremental growth say 10% to 15% growth in the book and the matured portfolio, you will see our convergence of actual whatever we are debiting to P&L will be the actual loss in the reality.

Ramesh Iyer: The other way round instead of RBI calling 30 days as NPA, IndAS has started calling it, RBI moved from 180 to 90 instead of moving to 30, IndAS has started calling it that way.

Nidhesh Jain: Lastly, on housing finance we have been guiding that gross NPA will decline, but as of now the experience has not been that great, so when do you expect in terms of timing by the end of FY '19, we should expect substantial correction in gross NPA or?

Ramesh Iyer: I think you will start seeing the progress happening from next quarter and then each quarter you will see it improve.

Moderator: Thank you. The next question is from the line of Sudip Dugar from Stewart & Mackertich Wealth Management Ltd. Please go ahead.

Sudip Dugar: Sir, I wanted to ask you on the rural housing finance segment that what is the kind of growth do you foresee in that segment?

V. Ravi: We have Anuj Mehra who is the MD of that company here, I will request him to take the question.

Anuj Mehra: Instead of giving you a growth number, let me just tell you what are the kind of potential we are facing. Today, whatever we have done till now we are currently roughly about 70,000 villages. Mahindra Finance itself is in around 300,000 villages, so immediately going up from 70,000 to 300,000 in terms of just a village coverage, and therefore, business coverage is a possibility. In addition about two years back, we started focusing on what we call affordable housing which is essentially semi-urban kind of housing space, where today we have roughly a 700 crore book, that itself is likely to be a fairly large growth engine in the years to come, so from one growth engine we are today talking about maybe having two growth engines going forward. These are statistics or data points which should give you some idea of what we see our potential growth to be, I would not like to give you a number on percentage growth.

Sudip Dugar: I just wanted to clarify one thing, this 70,000 villages and three lakh villages, this is the growth figure which has been achieved by the company?

Anuj Mehra: No, what I was saying is we are present whatever business we have done in rural housing till now has come out of 70,000 villages, put in another way there are 70,000 villages where we have at least one customer whereas Mahindra Finance has about 300,000 villages or three lakh villages have at least one customer as far as Mahindra Finance is concerned, so it is an indication of our access to villages.

Moderator: Thank you. The next question is from the line of Sangeeta Purushottam from Cogito Advisors. Please go ahead.

Sangeeta Purushottam: My question really relates to understanding the numbers that I am referring to Slide #34 where basically what we are seeing is that in Q1 this year, we have seen an increase in the yield and also the gross spread, what I wanted to understand was is this primarily because we have actually increased our rates or is there an accounting impact here because of the shift to IndAS that we are actually recognizing the income on some of the stressed assets because of the accounting change and therefore consequently is that the reason also why the NPA provision have gone up because, one, it is being added to both sides of the equation, that is question number one? The second question is that if we look at the drivers of ROE, it is primarily going to come from either a reduction in the overheads to average cost or reduction in the NPA provision and the leverage, just wanted to get your sense that as we move along the cycle, how do you see the three numbers panning out?

Dinesh Prajapati: To your first point, you are absolutely right in the IndAS accounting since the income gets recognized, the top line gets inflated to that extent and the same way the provision ECL cost goes up, so effectively it is a nullifying impact on the bottom line level, but you are right that it gets inflated on both the side of the P&L, so to that extent obviously it looks like the yields have gone up, so I would say large percentage of contribution is because of that and marginally there could be something which is because of the mix as well as our lending rate increase in line with the cost of fund going up, to some extent we have passed on that.

As far as the interest cost is concerned, it is a factor of capital infusion which happened in the period of November / December, so to that extent the benefit of it has flown in the interest cost area is concerned. On marginal basis, we still see that cost of fund is going up and to some extent on a blended basis still the impact may not be quite immediate basis, but if you ask me on a whole year basis, we definitely feel that it will have an impact of around 15 basis points on the cost of fund going up.

Sangeeta Purushottam: My question was that, you have been investing a lot in the past in terms of building us the capabilities on the ground. Now, as we go along we should expect the overheads to average cost percentage to come down as also the write-off percentage, which will translate into the ROE going up. Also the leverage at the moment seems a little lower compared to the past averages, so I just wanted to get a sense from you that what kind of a normalized NPA level should we see, what kind of normalized overheads to average assets are we likely to see over the next year or two, if you could give some guidance on that?

Dinesh Prajapati: As far as the IndAS, we will have to evolve and try to explain you, but in the past, we have guided that our debt-to-equity ratio will be around leverage ratio will be around 5.5 times to 6 times. Similarly on the quality correction is concerned, I think post our first annual results that is in post March result based on IGAAP were on a gross NPL of 8.6, which we had guided that we would be close to around 7%, so we continue to believe that as the economy is improving and the rural cash flows are improving, our directional improvement seems to be moving towards that and we continue to believe that we should be able to close around that number as what we have expressed in the last call.

Moderator: Thank you. The next question is from the line of Gaurav Jani from Centrum Broking. Please go ahead.

Gaurav Jani: Sir, firstly some conceptual understanding on the IndAS versus the RBI provision recognition norms, so just wanted to understand what is the difference in terms of recognition for the 30, 60, 90 buckets as compared to Stage-1, Stage-2, and Stage-3?

Dinesh Prajapati: As far as the IGAAP was concerned, it was clear that the NPA recognition was only for the 90 plus DPD and for a standard asset below 90 days, there was 40 basis points standard asset provision required on that. In the IndAS, there are three stages, the Stage-1 is all the standard assets, which is even zero day overdue or even a nil overdue customer plus up to 30 days of overdue customer falls under Stage-1 and any customer which is having a overdue beyond 30 days up to 90 days falls under Stage-2 and any customer above 90 days falls under Stage-3, and that is the reason why on a like-to-like basis, Stage-3 number will be a comparable number to the IGAAP number from the gross NPL point of view and as far as the off-book item, which is securitization in the earlier IGAAP regime, securitization was not considered as part of our book and which is why the NPL on those assets were also not recognized as NPL on the book. Now, since the securitized portfolio will be part of the book, even the contracts which we were under securitization and which are coming under the 90 plus DPD or Stage-1, Stage-2 will be considered as part of the book and will be recognized as NPL.

Gaurav Jani: You mean up to the Stage-2, the provisioning would have gone up as compared to the IGAAP?

Dinesh Prajapati: Yes, very much, because that was 40 basis points in the earlier RBI regime had a very clear stated policy on standard asset 40 basis points. Here, it will be based on historical data, which is why we have given if you have see on one of the slide the formula which is of PD into the LGD into the stage.

Gaurav Jani: If I have can a number as to what proportion of our assets would be Stage-1 and Stage-2 now, so we have 9.4 as Stage-3 if I understand it correctly?

Dinesh Prajapati: Balance is 91% is that, Stage-1 and Stage-2 together.

Gaurav Jani: Sir, secondly if I read this correctly, the QOQ rise in GNPA is 10%, right, it is not 2.5%?

Dinesh Prajapati: What we were saying was about the absolute migration from 7.7 to 9, that is how he was referring to and…

Gaurav Jani: Okay, on 250 basis points is what you meant?

Dinesh Prajapati: On a percentage basis, Yes.

Gaurav Jani: Sir, last question on the growth front, we are seeing the CV space and refinance and others going up pretty well, so what is driving this growth in terms of products and the ticket sizes and which regions are we seeing this growth?

Rajnish Agarwal: In fact there is an overall infrastructure story in the core sector and all sectors there is a growth. In fact all the OEMs, Tata, Mahindra, Leyland, all of them are doing pretty well, there is an industry growth of almost 72% in the industry in the first quarter, so at the backdrop of this industry growth, we are also getting good numbers for ourselves and this is largely led by infra, mining opening up, sand mining opening up in many states, so these are some of the reasons because of which the infra story is panning out and as the industry is growing we were a small player and our growth rate is also much higher than the industry growth, so we are also gaining market share.

Gaurav Jani: Sir, on the CV front, we are not focused on larger players or the higher tonnage vehicles is what I understand?

Rajnish Agarwal: We are focused in all tonnage vehicles, it is not that we are not focused there, we are there in all segments of profile of customers and all tonnage of vehicles we are present.

Dinesh Prajapati: However, our exposure to fleet operator or those kind of segment will be very small because we would be targeting the mid-size segment of the CV portfolio.

Gaurav Jani: Sir, also if you could touch upon the growth in the used vehicle space?

Rajnish Agarwal: Used, was basically, there was a slowdown because of GST and the cash restrictions which happened in the last year, so there is growth in that industry also and internally we have also opened many branches, gone deeper in penetration, so our growth is coming largely from rural and semi-urban geography where the pickup of these vehicles are happening substantially and we are growing in that segment and we are also not only in used cars, we are in used tractors, we are in used truck financing, so in all those segments there is growth, so all put together, we are getting a good growth which is balancing our portfolio.

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

Umang Shah: I just have one question, so clearly as you guys have highlighted that this whole ECL thing is going to be an evolving situation, but just taking cue from what Mr. Iyer alluded to that if the beginning of the year, we are at an annualized credit cost of about 200 odd basis points and if the asset quality or the outstanding pool of NPL or gross Stage-3 assets keeps on improving from here on, is it fair to assume that this number should kind of trend down and our full year average should be lower than that or maybe you guys would want to peg a number for the full year average credit cost?

V. Ravi: We will only say the direction is downwards, we will not tell you what it is because to be honest we ourselves have to see all these things, we are also learning along with you, so we will not like to put a number. I can only say that the rural cash flow is better, our collection is better, there is an asset growth, so from all angles things seem to be quite positive.

Moderator: Thank you. The next question is from the line of Karthik Chellappa from Buena Vista Fund Management. Please go ahead.

Karthik Chellappa: Sir, my first question is in developing this ECL framework, how many years of historical data have you considered?

V. Ravi: Four cycles.

Karthik Chellappa: That would be how many years?

Rajesh Vasudevan: For lifetime PD, it is 12 years, for LGD it is five years cash flow, and for PD of Stage-1, it is five cycles of one year, so five years, so it is different for different things.

Karthik Chellappa: Just to build on that, last three or four years we have actually seen quite aggressive NPL ratios because of a variety of reasons, assuming the rural outlook actually improved in the next one to two years, can we actually expect both the PD and LGD to see some sort of a consistent decline?

Dinesh Prajapati: Yes, there is a probability because ultimately every year all these ratios will be reset based on as Rajesh explained because the static period is going to be reset, so earlier period will go off and then new year will get added to the system, so like there could be in between some of the years like last few years we had challenging times, that is also added in this database. As the things start improving and the period starts improving the performance, it will also effectively give the benefit on the average basis, so that should reflect accordingly.

Karthik Chellappa: Sir, my last question is the gross NPA Stage-3 which sequentially have gone from about let us say 9 to about 9.4%, which was the category which saw the steepest increase and which was the category which saw the less steep increase?

Dinesh Prajapati: I think it is average most of the thing because the gap is not very wide for us to see spike in one particular item very disproportionately. However, seasonally the tractor portfolio will have some kind of delays more, to that extent only I would say there could be a slight gap because of the seasonality. Other than that, we do not see a very different movement in the vertical level.

Karthik Chellappa: Sir, just one data point, what would be our exposure to the cab aggregator segment at this point?

Rajnish Agarwal: Cab aggregator would be roughly of our total car portfolio will be sub 7% to 8%, roughly 1 lakh portfolio will be the car aggregator portfolio.

Karthik Chellappa: That is 7% to 8% of the car portfolio?

V. Ravi: Yes, overall 2% to 2.5%.

Moderator: Thank you. The next question is from the line of Sunil Tirmualai from Credit Suisse. Please go ahead.

Sunil Tirmualai: My first question again going back to the ECL calculations, so given that MMFS has reasonable, quite a high seasonality in the NPA movement, I am wondering over the next three quarters as we see some accounts upgrading in normal course of business, are those accounts to be tagged as a normal S1 or Stage-2 account or given that those had fallen into S3 in the past, you treat them separately and factor in a higher LGD to those?

V. Ravi: No, that is only for the bank, not for NBFCs. NBFCs, it is very dynamic, on the day of reporting if something is in 90, it is Stage-3 otherwise they are 1 and 2

Dinesh Prajapati: so any upgradation will move to the respective stage.

Sunil Tirmualai: So you do not distinguish between an asset which has been in Stage-2 all its life and another asset which is gone to Stage-3 and come back to Stage-2?

Dinesh Prajapati: Yes, because that is the IndAS requirement. IndAS requirement is very clear, anything more than 90 days overdue at a point of time will be reported as Stage-3, anything less than 90 and up to 30 days will be reported as Stage-2 and anything below 30 days will be reported as Stage-1. Now for the purpose of calculation, it says that for the purpose of Exposure at Default definition, which is what I explained it has to be seen when he went into the first-time into 90 days for deriving his principal value of LGD, he is on that day what was his principal value and on that interest income start accruing as if he was going to service the loan, so it is a calculation formula is derived based on that.

Sunil Tirmualai: You mentioned overall portfolio LGD of about 27%, can you give some flavor across the large three to four segments how this number varies?

Dinesh Prajapati: It is a composite number, we have not shared this number, in fact we have calculated on portfolio basis at this point of time.

Sunil Tirmualai: You actually do not do it on a segment basis?

Dinesh Prajapati: No.

Sunil Tirmualai: On the housing finance business, what proportion of the portfolio is from Maharashtra?

Anuj Mehra: Close to about 45% to 50%.

Sunil Tirmualai: Which are the other large states?

Anuj Mehra: Tamil Nadu will be other large state for us followed by Andhra, Madhya Pradesh, Gujarat, etc.

Moderator: Thank you. That was the last question, I now hand the conference over to Ms. Bunny Babjee for closing comments.

Bunny Babjee: On behalf of JM Financial, I would like to thank Mr. Ramesh Iyer and the senior management of Mahindra and Mahindra Financial Services and all participants for joining us on the call today. Thank you and goodbye.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of JM Financial, that concludes this conference call for today. Thank you for joining us and you may now disconnect your