"Mahindra Finance
Q1 FY2020 Earning Conference Call"

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ANALYST: **MR. KARAN SINGH – JM FINANCIAL**

MANAGEMENT: **MR. RAMESH IYER – VICE CHAIRMAN & MANAGING DIRECTOR – MAHINDRA FINANCE**
MR. V. RAVI – EXECUTIVE DIRECTOR & CHIEF FINANCIAL OFFICER – MAHINDRA FINANCE
MR. DINESH PRAJAPATI – SENIOR VICE PRESIDENT – TREASURY & CORPORATE AFFAIRS – MAHINDRA FINANCE
MR. RAJESH VASUDEVAN – SENIOR VICE PRESIDENT – MAHINDRA FINANCE
MR. RAKESH BILDANI – DEPUTY GENERAL MANAGER – TREASURY & INVESTOR RELATIONS – MAHINDRA FINANCE
MR. VISHAL AGARWAL – DEPUTY GENERAL MANAGER – TREASURY & INVESTOR RELATIONS – MAHINDRA FINANCE

Moderator: Ladies and gentlemen, good day and welcome to the Mahindra Finance Q1 FY2020 Earning Conference Call hosted by JM Financial Institutional Securities Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Karan Singh from JM Financial. Thank you and over to you Sir!

Karan Singh: Thank you. Good morning everybody and welcome to Mahindra & Mahindra Financial Services earnings call to discuss the Q1 FY2020 results. To discuss the results, we have on the call Mr. Ramesh Iyer who is Vice Chairman and Managing Director, Mr. Ravi who is ED and CFO, Mr. Dinesh Prajapati, Senior Vice President, Treasury & Corporate Affairs, Mr. Rakesh Bildani, Deputy GM, Treasury and Investor Relations, and Mr. Vishal Agarwal, Deputy GM, Treasury and Investor Relations. May I request Mr. 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: Good morning. Thank you for joining the call. Unlike every year where I spend less time explaining the accounts, but I think this time, I would put in a little more effort to explain what these numbers are. And Karan, just to correct you, instead of highlight it maybe good to call it a lowlight on the NPA to explain because that will then put to rest the confusion that must have arisen out of the high provision that we have.

Just to kind of recap, the Mahindra Finance business model historically has always been that post the March quarter, we do see increase in NPA in the first and second quarter, and as the cash flow starts flowing in, the third and fourth quarter sees the correction. Even the very recent year gone by, if you look at, we started the year at somewhere 9.4% as an NPA and closed the year at 5.6%. Even in the April call, we had made a mention of will 5.6% remain there and we had said that it is likely to move closer to 7% or so. And we are not surprised that the NPAs moved in that direction. But yes, what else has happened for the provision to remain at this elevated level requires an explanation.

Under the Ind AS, the ECL method of accounting, anything that comes into NPA, we are required to make the expected loss provision upfront. We do not take into the benefit of the period of the contract or the seasonality, etc. And therefore, the increase in NPA between March and June has got fully provided in this quarter.

Now look at an example of let us say that all these contracts are the customers which are not currently NPL, remain in NPL through the year, we will not require to make any provision on those contracts for the next nine months. So in a way, to look at it is that the provision required on these customers for the year has all got provided upfront.

Now in order to arrive at the modeling, one way to look at it is to say that if through the year, the income is going to grow at certain level, the cost is going to go in one direction. And if this is the provision which is already made fully provided for, then where does the profit end up? You will see we will catch up for the year.

Now clearly, these are not the only customers or contract that we have in the book. Therefore, there will be some who will come in as an NPA going forward and some who will go out as an NPA going forward. Now will 7.4% therefore like last year, 9%, or 9.4% became 5.6%? Do we expect that the 7.4% will proportionately therefore come down in the same manner? May not be but we do definitely expect that the last 2 quarters, as we always expected, the cash flows remain buoyant. We will definitely see downward improvement to the gross NPA of these customers.

It also therefore will largely depend on how does the book grow in order to look at how the gross NPA looks like on a grown book. But clearly, we are very comfortable and confident to make this comment, that on these contracts, which are now in NPA, we will not be required to make any additional provision in the next nine months, looking at the modeling of the ECL that has gone into. This means that if there are write-offs that happened from for these customers, only line item change will happen. Something will come as a write-off and it will reduce the provision to that extent, unless we see that their value of the asset that we dispose of is substantially lower in realization value as compared to the estimated loss that we have made. But the estimation that we have made is based on substantial data and the experience of the past. And we do not therefore expect that there will be a big difference even to the loss pool, if we were to make a provision for the losses and reduce it from the provision.

Therefore it is extremely, extremely important to understand that while we have registered a good growth in our asset, while we have maintained our net interest margins at around 7.6%, there is a slight dip over what it was as of March 31, 2019. But that will also again catch up because two things that happened here is, one, it is a product mix change; and the second is the little elevated cost of fund. And we are definitely seeing the reducing trend in the cost of money as well. And therefore, if the product mix remains the same, we do not see that we will miss out on the gross spread levels.

When it comes to the overheads to assets, also, there has been a slight increase. But I think there are certain one-timers, which have come into the overheads that we have provided for. And maybe at a later stage, that would be a question where we would put in an explanation more clearly on this.

But I think one clarification that I want to offer on the overheads as well. So far, we were looking at overheads just as a percentage to asset, which is important. But it has three elements in this cost which one needs to look at: one, the cost of acquiring a business and growing the business; second cost is towards collections and maintaining asset quality; and the third cost is little investment in the future. So in the past and continuing to remain that way is a cost which has been incurred for collections and asset quality maintenance. We have added people. And therefore, as of March 31, if that cost has already come in, they will continue to remain also in the first quarter but do not produce the same kind of a result that was produced at March 31. So as we see the year go by, you will see this cost as well get better produced. And therefore, the productivity will kick in for this cost to come down as well.

So our concern honestly is not on any of these line items. While the P&L does reflect the pressure, but it is not a pressure or a reflection of any rural stress that is being generally discussed about. Because one other data point that I may want to offer to prove this point is the collection efficiency of first quarter last year and first quarter this year has remained exactly the same at 92%. So we have not seen any pressure from a cash flow perspective in rural.

But does that mean that customers have enough money, and therefore, why are they not buying assets? I think the customers have money and they want to discharge their liability. But by very clear sentiments, they are not in a mood to acquire asset, and that is very clearly visible from the overall volume shrinkage that we are seeing for OEMs.

In spite of the OEMs degrowing anywhere 15%, 20% for different products at different points of time, we still have added disbursement growth of 3%-odd. And we do think that come October onwards, we will see volumes kick in. And I am not again saying they are big fundamental change, but they would definitely be a beneficial transactional change because the inventory will put efforts to liquidate by various programs from OEM. And for someone like us who is so deep-penetrated and multiproduct, we'll get the benefit of that volume as well.

And clearly, therefore, our approach to the whole growth story is we believe that the disbursement growth can be somewhere in the vicinity of 10% as we close the year. And therefore, the asset growth could be upward of 15%-odd, the way we have looked at for the year. There could be some temporary benefit that we could get if the volumes are higher than what we forecast, but the organization structure is extremely flexible to be able to take benefit of that.

But as otherwise, we think that we have a very strong collection structure, which has the ability to maintain efficiency and which has the ability to bring back the asset quality to where it should be. And we have not seen any changing trend in this quarter as compared to any past. It has always been that the first quarter pushes up the gross NPA and it starts to correct. As a matter of fact, if you look at in this quarter, we have 7.4% is 2% lower than where we were the first quarter of last year. And because we do not have the luxury of providing step-based provision, we have to take all provisions upfront. Therefore, the P&L goes through that pressure, whereas it will get corrected as we unfold quarter after quarter.

So our summary take is that the performance of the company, while you look at it from a pure profit perspective, it looks to be under pressure. But if you were to look at it from different aspects of how this business is built and compare it to the model of any past experience, we are very comfortable to tell you that we are in the path of definitely growth and we are in the path of bringing about the correction. And we are not worried about these things slipping from what we generally hear as the rural slipping.

So that is not our take. Our take is the customers do have money. Customers are wanting to discharge liability. But customer sentiments are not aggressive for them to acquire asset, and therefore, the asset growth could be a little muted. But we do not have a fear on our ability to maintain collection and continuing to show decreasing trend on the NPA front.

I think, overall, this is what we think from a liquidity perspective. I do not think we have had any pressures in our ability to raise funds from the market. We have been able to raise funds from every possible source that was available to NBFC. While the cost did remain elevated last November through up to January, then on we have also started seeing the correction to the cost. But yes, we have committed lines where we have already agreed for certain rates in the past. And until they get replaced with new funds, we will not get the benefit of the changing trend. But surely, we do not see this year to be a year where interest costs will be moving up. We would see this year to be an interest regime where we would see interest costs correcting downward.

As a matter of fact, we will continue to focus on our deeper penetration as our strategy. Where and how required, we would add branches to the extent required. And we would definitely bring in efficiency through better use of technology and data to be able to curtail and control cost. But I have always explained that this is a fixed cost only up to regional level. Then on it is a variable cost. And once we have people in place for handling volumes and for handling collection, to that extent, they will remain variable. And as we complete the year, you will see the efficiency benefit of this cost. While at any point of time, to start with in the first and second quarter, it may look elevated, they get offset as higher volumes and higher collections starts to kick in with the same number of people in the second half. And that is why you will always see that beginning of the year, it remains elevated and it kind of tampers off at the end of the year.

So much from our side, and then we are open to questions on all these fronts so that we can provide you detailed explanation.

Just a few couple of lines on our subsidiaries. All our subsidiaries are also remaining profitable, and they do not go through any new problem as compared to what I have explained as what we have from the marketplace. The major subsidiary, that is rural housing subsidiary, also has a similar problem in terms of elevated NPA levels. And as we explained even in our last round, it is still cost only through Maharashtra. And the earlier that they would come out, as I have been saying, is around the harvest and plus harvest time.

At least what we see is a marginal improvement that's already visible in this market. And the pricing power is substantially high to be able to even absorb this kind of a cost. But it is a profit to be made as and how we will start seeing the corrections to come through.

I think as a subsidiary, with the level of pressure that the housing venture went through, there was a pressure on the liquidity front for their ability to raise adequate funds. And given their asset quality, they took a conscious decision to be a little slower on disbursements. But you would see them back in business in terms of line of credit already agreed upon and getting back to business, and we would see correction of NPA happening as we get into the third and the fourth quarter.

As far as the insurance distribution business, again, their profitability has been healthy except to the extent that they have made certain advanced investments into new line of business, including digital means of doing businesses. And the benefit of those expenses is yet to be got by us. And again, they all are investments made to be future-ready and they have been expensed out and therefore, you would see a little pressure on their profitability. But it is not a pressure out of shrinking margin. It is a pressure more out of investment made and expensed out for future readiness.

As far as the asset management company is concerned, I think all of us must have read that we are getting into a joint venture with the Manulife, which is one of the leading insurance companies. And we very strongly think that they will bring on the table a lot of knowledge on the business, their technology capability, product designing capability. And with our ability to be able to take them to the deeper pockets and grow this business, we will be cautious in how we want to and how much we want to invest into. But with this joint venture coming in, they are bringing in 49(%). The money is actually what will come into the company, and therefore, we may not be required to infuse any fresh capital for the next couple of years based on the projections that we have made.

So far as the Mahindra U.S.A. venture is concerned, again, the market there out is a little slow. And to that extent, the volume for us is also low. But we are continuing to remain profitable giving a return of around 12%. And we do have a penetration of about 60%-odd in that market. Again, given their growth rate, we have not required to maybe infuse any fresh capital immediately. But all ventures therefore are able to maintain their growth, but the benefit of the growth would definitely be witnessed at least in the Indian businesses, we are very confident to see some growth trajectory post the September quarter that is from October, the festival season, since almost all businesses are working in the semi-urban and rural market.

So much from our side and we can possibly open it up to Q&A and wait for people to ask us any questions that they have.

Moderator: Thank you very much. We will now begin the question and answer session. Anyone who wishes to ask a question you may press'*' and '1' on your touchtone telephone. If you wish to remove yourself from the question queue you may press'*'and'2', participants are requested to use handset while asking the question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Mahrukh Adajania from IDFC. Please go ahead.

Mahrukh Adajania: My first question is on new feelers of asset quality for the second quarter, though not much of the quarter has gone by. But do you have any feelers in terms of how collections are going? Or if it all, there is any stress that you see in the second quarter which is more than what you had expected?

Ramesh Iyer: No, so clearly as I said, the customer out there do have money and therefore, cash flow is not the pressure. Their prioritization is the pressure, so they are not wanting to use their money for asset acquisition, whereas we do see they are willing to discharge their liability. So as we speak, while we are 20 days down in July, we have not seen any new signals of stress for us to worry about if the quarter is going to go the way that we want it to go.

Mahrukh Adajania: Because it is hard to tell and how do you tell for sure that if the client is not investing in new assets, he will not stop paying also, that is the issue right?

Ramesh Iyer: No, that is not the issue. I think the issue is if the customers are earning from the assets that they already have, they would for sure discharge their liability. They are not wanting to bring in additional margin money to be able to buy assets. If somebody is willing to give them 90% loan, maybe they will put in 10%.

Mahrukh Adajania: Got it and my other question is on liabilities. Of course, with brand, you should have no issues raising funds, but there are some reports that banks are now refusing to lend even to the very top rated NBFCs maybe because a lot PSU banks have hit their limits or whatever the reason? Is that correct at all?

Dinesh Prajapati: No. So as far as banks are concerned, they had a challenge last year for sector cap because the REC and PFC continues to be part of the NBFC as a sector, so sector limit is always blocked based on how these companies borrow from the banking channel from the PSU bank, so every time, when you go out to them, they will always look at what is there present position vis-à-vis the sector cap, but we are able to still raise from some of these public sector banks, so we do not see that as a big challenge, from the public sector bank. The challenge is that still the public sector bank lending rates continues to remain slightly more sticky. They continue to demand the spread over the MCLR, so I think that is the challenge.

Mahrukh Adajania: And has the spread increased in the last five to six months, it should not have, right?

Dinesh Prajapati: No. So what was increased during the quarter of October to December that has now reduced, but it is still they continue to remain slightly elevated compared to the other private banks and the foreign banks.

Mahrukh Adajania: But there is enough from private banks and foreign banks to restock that the PSU gaps right?

Dinesh Prajapati: Yes.

Mahrukh Adajania: My next third question is on write-offs, what were the NPLs written off during the quarter?

Dinesh Prajapati: Rs.90 Crores.

Ramesh Iyer: Rs.90 Crores.

Mahrukh Adajania: Thank you.

Moderator: Thank you. The next question is from the line of Abhishek Mody from Asit C. Mehta. Please go ahead.

Abhishek Mody: Thanks for taking my question. Just first thing, you said it earlier do you still expect a disbursement growth to be 10% and AUM to grow 15%? That is my first question. Second, Sir, in terms of NPA provisions of new accounting standards, are the provisions made more on the macroeconomic environment or is it more so to do with account specific? You are lending to farmers and people in the rural area because of those, you consider to see the provisions in macro or micro and third, Sir, you told that you do not accept more provision, but if you see the provisional coverage ratio is 24.9%? In the previous year, I think was around 35.1%, so are you still hopeful that you do not expect to see more provisions in the next three quarters of the current year?

Ramesh Iyer: No, so let us first clear the first one, where you said 10% and 15%. Yes, that is our expectation based on the festival demand that we expect that it will pickup in the auto and tractor segment and we would get the benefit of it as against the current 3% odd disbursement. We think that, that is the kind of numbers we look at for the Q3 and Q4. In as far as the provisions are concerned, when you say that 35% was in the Q1, but it had come down to 19% as of March 31 2019. So I think once an account is an NPA and we make 30% of whatever is the X percentage provision on the base of ECL, I am saying we are not required to make any additional provision on that account based on the ECL calculation.

Abhishek Mody: Sir, I think you are talking about the reversal, which you made in Q4, I think, there was provision reverse in Q4, so you are talking for Q2 you make a provision, but by Q3 and Q4 you see?

Ramesh Iyer: You are not getting the reversal. Like you look at even last year, we started with 9.4% and ended with 5.6% and in Q4, we actually had a credit, right? Yes, but at the same time, it is not appropriate to imagine that whatever account has an NPA will be the only account which will remain an NPA. You will get some new account coming in NPA and there will be some from NPA will got out as well. So to that extent, let us say one truck account comes in and their tractor account goes out, there could be some differential provision which will come in because the value of assets are different, right. Let me come to that. I will answer because the calculations are on the basis of only macro or micro. I think it is a factor of all. We do look at how the macro is. We do look at how our portfolios in the past have behaved and therefore, what is our experience of that and we do take into consideration what are the efficiency factors currently in force. So it is an element of all. It is not just based on certain macro future, to say that everything is going to be good, so no provision required to be done or no loss will happen. Or nor is it absolutely based only on the history to say that because conditions historically would have been different from conditions futuristically. So it does take into account all of these elements. It also takes into account various products that is considered in the portfolio to arrive at this. So it is not past experience of truck will be applied to the current experience of a three wheeler.

Abhishek Mody: So you are telling both?

Ramesh Iyer: All. I am saying all four macro, micro, the current portfolio and the current happening at the marketplace.

Abhishek Mody: Sir and just the final question in terms of the NPA in the subsidiary, I think Rs.57 Crores of provision is put if I subtract the consolidated and the standalone basis?

Ramesh Iyer: One second. We will just look at the number and let you know.

V. Ravi: What is the question?

Ramesh Iyer: No, he is saying what is the provision for our subsidiary? Consol minus your standalone the difference.

Abhishek Mody: Rs.57 Crores that is minus subsidiary and that will be only the rural housing part, if I am right. I just want to?

Ramesh Iyer: That is the only subsidiary which has a provision. So you should be right, but maybe we can come back with that or somebody will call you and message you that number. They will just look at it for clarification. During the call, we might tell you.

Moderator: Thank you. The next question is from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

Nagraj Chandrasekar: Thank you very much. Two questions, first if we go into what drove the provisioning under Ind-As, it is typically a combination of the expected slippage or expected loss and then multiply that by LGD could you give us a sense, over the last few quarters, which of those variables has moved up? Is it that you are expecting to see greater defaults or is it that you are expecting to see a greater loss given default? And second, could give us some sense, there has been a lot of footprint expansion by small finance bank, other NBFCs, etc., how is the competitive environment changing for you and in which verticals are you seeing tighter competition?

Ramesh Iyer: So by the time they pull up the other figures, honestly speaking, we do not yet see any major competition from any new set of players. These were all existing in some format. The format has changed. Let us say if AU Finance was an NBFC then has become a bank over time or a Bandhan was within micro finance has become a type of a bank. So I do not think we have seen any new player emerge, just as the format has changed. And therefore, we do not come under any pressure of seeing a new competitive pressure out there or any of this player going more aggressive and pushing us to do certain different things. No. I think it is just that the overall volume of the market has come down and all of us have either maintained market share or some of us have even gained a little market share to get whatever benefit that we give. So I do not think the competitive pressure has substantially changed or increased for anything to go the other way around. The other question of what are the changes that has come in, Rajesh will just kind of let you explain.

Rajesh Vasudevan: There are two changes, so we have reset the rates of PD and LGD during the quarter from March, so PD it has come down by 2%. Our LGD has gone out up by 2%.

Nagraj Chandrasekar: Got it and is that what, but you are saying that does not necessarily have to do with the extra provisioning that you have taken?

Ramesh Iyer: The provisioning is if you look at March 31, 2019 versus June 30, 2019 and this is typical of the rural model where the NPA goes up in the Q1 and Q2 and then starts to correct in the Q3 and Q4, so it is just purely number of account going up in this quarter, which will reverse itself in the Q3 and Q4. So even if you look at last year, I have been saying this over, we started at 9.4%, ended at 5% point odd to 6% or whatever is because what started off as an NPA, the customer starts to get their money after harvest and then they start to repay or they start getting their money from the government treasury for their infra work that they have done and they start discharging their liability. So this is typical of this model where you would see a little increase happening in the first couple of quarters and then the last two quarters will start to see corrections.

Nagraj Chandrasekar: Thank you.

Moderator: Thank you. The next question is from the line of Digant Haria from Antique Stockbroking. Please go ahead.

Digant Haria: I just wanted you have explained it very clearly, but just to put it in numbers that our NPAs have gone up by say Rs.1220 Crores for the quarter and we have taken roughly Rs.610 Crores of provision, so which is if I just do a like-to-like it is like 50% provisions on whatever NPA had come and is this a reason why you say that for the first year, whatever happens to this account, we do not need to take any provisions?

Ramesh Iyer: Yes. When we arrive at the expected credit loss that means we are providing for, in this account, whatever there are forecast of losses. Unless that calculation changes substantially, there will be no additional provision required in these accounts.

Digant Haria: Sir we have provided under iGAAP, say, last year for the same Rs.1220 crores,just a theoretical question?

Ramesh Iyer: Let us say that if Rs.1220 Crores are all in the first bucket right so 10% or whatever we provide 15% or 10% that we provide, it would have been Rs.180 Crores.

Digant Haria: And versus that we have provided roughly Rs.500 Crores to Rs.600 Crores?

Ramesh Iyer: Yes, so we provided almost more than double of that or a little more than that.

Digant Haria: Fine Sir that was the only question I had. Thank you.

Ramesh Iyer: There was one clarification required by someone who asked a question on the housing NPA provision. That was Rs.57 Crores. Yes, that was the right number.

Moderator: Thank you. The next question is from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave: Thank you for the opportunity Sir. Sir, one just quick followup on what you mentioned. The probability of default is around 2% and LGD is up 2% so my understanding is that it is a rolling on number?

V. Ravi: No it is not 2%. It has gone up and gone down by 2%.

Agastya Dave: Yes that is what I meant, Sir. The PD is down 2% and LGD is up 2%. My understanding, it is a rolling on cumulative calculation. So how do we interpret this variability? Will this be like a minor blip or a fairly big movement? Can you give actually the LGD number, the actual number now?

V. Ravi: Actual number we will give. Just to answer you we were at 180 days earlier when the modeled start. Now as we start replacing by six months, the earlier six months we removed and the recent six months we add. As we start coming nearer and nearer, as we become more contemporary, we will be reflecting NPAs recognized on the basis of 90 days past overdue. Hence, normally, NPAs past overdue, the probability of that will come down as compared to the 180 days. Stickiness of the 180 days is much more than 90 days stickiness. Hence, the probabilty going forward, assuming there is no market turbulence, going forward, the probability of the default will come down. How much? Of course, time will say, but the LGD will be a factor, as I told you, of supply, demand, resale, all those. I cannot comment on the LGD.

Agastya Dave: Yes. I get that point, Sir. Sir, my first question was that one of the largest private sector bank and they have a subsidiary, which also is in this business and on their concall they mentioned that they have seen asset values declining in the auto sector and hence, they had taken additional provisions and you mentioned that you have not seen that kind of impairment, so would you agree with that? I mean are you seeing that, or is this a minor thing, which is just company specific?

Ramesh Iyer: I think it is an outcome of the product mix, like we have almost all products. If somebody has let us says a little more of certain range of commercial vehicle, could they be seeing it a little differently or if they are overly present in certain geography and not widespread across the country, then it could be a behavior of a certain geography as well, right.

Agastya Dave: My guess is that they were referring mostly to CVs, that would be my recollection?

Ramesh Iyer: More to CV and more to maybe fleet operators.

Agastya Dave: Maybe, Sir.

Ramesh Iyer: So therefore, it depends on the exposure that you take on the client in terms of, suppose I have given a 90% loan, right therefore my gross ratio will be higher than when I repossess and sell.

Agastya Dave: Asset values, as such, Sir, are you seeing any impairment there?

Ramesh Iyer: Not yet to the extent yes, the discounts on the vehicle are definitely impacting the resale price.

Agastya Dave: Sir, one last question, Sir. When the initial slowdown started last year, people were saying that it is because of the NBFC liquidity issues and also high interest rates. And it was as you have mentioned. So my guess is that if those things started reversing, do you expect this particular change of liquidity situation and lower interest rate, would that sooner or later be enough to reverse the slowdown? Or it is a much bigger structural issue? How do you see it? Because your commentary on how the consumer is actually behaving is pretty interesting and slightly not what I expected. So how do you look at the liquidity part?

Ramesh Iyer: I am of a view that neither was NBFCs non-lending nor the interest for the cost of the slowdown in this industry. So I do not accept the theory at all, because we have not refused anybody to give money and if somebody else has refused to give it if the client was acceptable, we have lent to them, which is why we have gained little market share. Like us, somebody else has also gained market share. So this could be kind of an OEM, out of 10 answers for the slowdown, this could be just one part. But these are not the triggers to either drop it or grow it. Similarly, interest costs like fuel, is an operating cost for an operator, if he is in a commercial kind of a business, yes, a personal car user may say why should I buy a car if the interest rate is so high, I would rather wait, right? But if you were to look at overall auto industry, it is not represented only by personal use car. There are pickup vehicles. There are vehicles, which are put for tourist use. There are vehicles like Ola, Ubers of the world, there are vehicles which are in people carrier, tourism, if there are cargo carriers and they are not honestly driven by interest cost. While they negotiate for the best interest. No sooner they know their cost of borrowing, they factor it in their pricing to consumer. So therefore, interest is things - normally, I have seen the vehicle decline happens when the capital cost of acquisition goes up. Like if the vehicle price was to go up by 10%, 15%, I think there is a pressure and therefore they say, is there an urgency to buy. If their exchange vehicle drops substantially in terms of resale price and that is inefficient margin for the new vehicle purchase, then the vehicle sales go down. Otherwise, through operating cost, there could be a delay but never a decision not to buy because if I ever demand for a vehicle, I would be able to price accordingly. So the operating cost is actually looked at over use of the vehicle for next five years, seven years kind of a thing and they believe that they will cover it up. So I have a very strong, different view on the industry dropping is not an outcome of the operating cost. I think it is clearly an outcome of sentiment in my opinion. Why do I acquire a vehicle now if I do not see a high load factor or a use of the vehicle waiting to happen? So I think that people are waiting for infrastructure story to open up, people are waiting for the post-harvest outcome of how the yields are going to be and how the farm cash flow is going to be. If these two fundamental cash flow starts showing positive trend, my guess is that there is restructuring, a positive trend, even acquisition of the asset classes.

Agastya Dave: Thank you very Sir. Your commentary was very, very useful today. Thank you Sir.

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

Darpin Shah: Thank you for the opportunity. Repayment rates are lowest for last - in the last several quarters. So how do we read into that?

Ramesh Iyer: Repayment what? Sorry, I missed it.

Darpin Shah: Repayment rates within the whole book.

Dinesh Prajapati: CV book growth is there higher. If you see last couple of years, on a low base, CV growth has been almost gone up by 7% to 8% on overall book composition. And that book is having - almost all the loan is in the four to five year bracket. So effectively that runoff will be slightly slower compared to the other book.

Ramesh Iyer: As compared to that, in the earlier book, we used to have three-wheelers which is to run off in two years so the three-wheeler volumes have come down so both of these factors happened.

Darpin Shah: Okay. So that is the only reason you see. You do not see any reason in terms of - you do not see any foreseeable pain coming because of slower repayments or anything else?

Ramesh Iyer: If you look at our collection efficiency even in this quarter and compared to first quarter of last year, it came at 92%. So we do not see non-payment as the reason for the asset continuing.

Darpin Shah: Okay. And my second question is our coverage is still 25% only. So do you see on all your assets or appeared LGDs should be at this level only? Or do you see a chance to increase these provisions because of where the environment is?

Ramesh Iyer: As I said, we look at various factors to arrive at that and if we see clearly that some of the factors are very adversely behaving, then we will have no choice but to make those corrections. But otherwise the coverage in my opinion, the coverage has lost its importance. If we are now forecasting the expected loss and making a provision, we do not expect that finally when the asset has to be either repossessed and sold, to make losses higher than this. And this is built out of history. Now clearly, if we think that, let us just as an example. Suppose let us say that certain assets the manufacturers discontinued. They do not produce that asset, and the resale of that asset substantially starts to drop. We will have no choice but to bring in that factor and then accordingly the expected loss will be pushed up. In a regular used product, in a similar pattern of product mix, in the same geography where the economic drivers remain the same, we do not see this factor to change substantially. But if any of these factors undergo change, it will start bringing in, in that formula, to that extent either it will go up or go down, will start happening.

Dinesh Prajapati: Please note that if you recall last March also when we did a write-off, we have a write-off policy every September and March. So whenever we do write-off, the proportion of the contract, which moves out of the NPA for that differential portion of over and above the LGD goes up from the provision value. So effectively, the coverage outcome will be a percentage derived based on that. So you will have to consider that factor every September and March for the provision coverage value.

Ramesh Iyer: Like 35% first quarter last year, closed at 19-odd percent as we reached March.

Darpin Shah: So that is what I am saying. So you feel that in current environment, this should be good enough unless something drastically changes?

Ramesh Iyer: Yes. Surely.

Darpin Shah: Okay. Thank you. That is all from my side.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from BOB Capital Markets. Please go ahead.

Shubhranshu Mishra: Thank you for the opportunity Sir. My first question is with regards to any new product that you are launching especially in consumer durables and personal loans?

Ramesh Iyer: Even if the answer is yes , they are not game changer. I think we are launching through digitally for our existing consumer. I would more think this year would be a test-bed of that as to how much of that is required and doable and what is the support OEMs are willing to give. But there would not be some kind of a large disbursement to offset the slowdown that we are seeing in the auto and all that. It will be a very, very small portion for the year. But that is one product that we are very surely looking at that as our need to be in going forward.

Shubhranshu Mishra: And personal loans as well, Sir?

Ramesh Iyer: So this will - I mean if you look at even consumer durable is as good as the personal loan. So we call them as a small-ticket loan rather than quantifying them as personal or consumer durable.

Dinesh Prajapati: These are credit-based lending models. So effectively, these are first-time properly evaluated credit customers and based on that.

Ramesh Iyer: Good customer, good track record, history of current repayment track record of these consumers will be the parameters which will go into deciding, first of all, who should get. And then based on how much have the repaid, we will decide how much will they be given.

Shubhranshu Mishra: So it is a fair assumption that it will be largely cross-sell product.

Ramesh Iyer: Yes. To those customers, out of the three year loan who have repaid 12 months and they have repaid without a default.

Shubhranshu Mishra: Sure, Sir. And secondly you have been alluding to collections. If you can elaborate on your collections infrastructure, how many people you have deployed, branch level activities and regional, any centralised - regional-level activity, that will be helpful, Sir.

Ramesh Iyer: I think if the company has about 20000 people, it is safe to assume 35% of them will be in collection. And they would be by branch and they would be assigned number of customer at that level. And they are being assigned bucket-wise collection, which is someone managing a 0-1 bucket, someone managing the two bucket, then somebody managing the three bucket to not allow it to go beyond that. And then we also have a mix of legal and settlement kind of a team attached to the collection beyond four and five installments so the recovery from NPA accounts starts to kick in. And there are team which is monitoring the repossessions and disposal of vehicles and the stockyard management.

Rajnish Agarwal: And the first year is also handled by the business team, first-year collections.

Ramesh Iyer: Yes. So any business that has been done, let us say, this month will be managed for the next 12 months by the business team who have a separate collection team with them. And once they manage the first 12 months collection, then it is turned over to the soft bucket team, which is a pure collection team.

Shubhranshu Mishra: Right. Sure, Sir. And my last question is with regards to your high NPAs, in your rural housing business, Sir. They have been largely sticky at similar levels, double-digit levels, for a very long period of time. So how do we look at the gross NPAs in rural housing?

Ramesh Iyer: I think if you were to knock off Maharashtra from that, that they come done to a 6%, 7% kind of a level. And I think we assume that, that should be the level this business should see if the geography performance is good. We believe that Maharashtra would start doing correction post-harvest, but it is unreasonable to expect that in one season or in six months, all corrections can happen. But Maharashtra will first climb down from wherever they are to a 10%, 12% kind of a level before they can start moving down. So I think it is safe to assume that until Maharashtra fully corrects, the NPA would be in the range between 9% to 11% kind of a thing. Once Maharashtra corrects, then we will start seeing it closer to 8%. And one should assume this will start to show color post-October and will take about a year for it to really reach those levels.

Shubhranshu Mishra: Sure, Sir. And just one data keeping question. So if you can give me the 0 DPD in each of your asset class?

Ramesh Iyer: Each, I cannot. But as a book, I think we will be somewhere around 80% also.

Rajnish Agarwal: 80%.

Shubhranshu Mishra: Sure Sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

Jamshed Dadabhoy: Thanks for taking my questions. I have one question, which I want some clarification on, on the tractor side. Your presentation seems to indicate that tractor industry volume growth will be between 2% to 4% CAGR on a medium-term five-year basis from FY2019 to 2024. However, when we look at the group company, Mahindra & Mahindra, their tractor outlook over the medium term ranges between 8% and 10%. So I just want to get a sense of why there is discrepancy between what you are forecasting and what they are forecasting.

Ramesh Iyer: I think as a parent, I would think their forecast is more correct than our forecast.

V. Ravi: See, basically what we do is CRISIL report they have uploaded. It is not seen to this Mahindra Finance. If you see all the reports, OEM reports that CRISIL reports, which is not Mahindra Financial has got any projection or something like that. But as Ramesh said, that OEM projection…

Ramesh Iyer: I mean if we really were to total, and we have seen this not just in tractor. You speak to any industry, you talk to five OEMs, you will get maybe five different projections that they have in their mind. And you total it up, it can sometimes exceed the total production capacity. So I think we, as financier, while I do not know why this number we are even putting it out as CRISIL or whatever, we are concerned with the volumes available for financing. I mean I do not even care industry growth at 6% or 2% or 5%. We know that we need to do "x" number of tractors. We know it by geography, by dealer. And we are therefore looking at what is the volume we have to do. Market share is arrived at by taking a denominator of what the dealers says I sold 100 tractors. It means nothing to me. If I go 10 tractors, my income is what we generated out of 10 tractors. But then the market share is 32% or 2%, whether the industry has grown at 10% or 5%. So for a finance company, the absolute volume is what is the key. But just to get a feel of what someone is talking about, we pick up this number. CRISIL says it is 2%. For all that you know, as we speak, CRISIL may put this number upward and make it 5%. So these are very moving, moving kind of a target and it has, I do not know how many factors which go into. My personal request would be we should not even try to reconcile these two numbers.

Jamshed Dadabhoy: No, it was just an observation because it is a bit jarring that in the same group, one company has such a different forecast. And I am - if it was year or annual forecast or something, I would not even have bothered to ask. Or if it is a five-year forecast. I just wanted to get your sense.

Ramesh Iyer: No, no, no. One clarification you should have is ours is not a forecast. Ours is a cut/copy-paste sheet of paper. Their's is a forecast. So you may want to talk to them and understand what goes into their forecasting it. Ours is a cut/copy-paste of CRISIL. I am sure we will have put some out...

Jamshed Dadabhoy: Okay Sir. All right. Thank you.

Moderator: Thank you. The next question is from the line of Pratik Chheda from IIFL. Please go ahead.

Abhishek: This is Abhishek. So I have two questions, first one is on opex. So can you talk about the one-offs that you mentioned in your opening remarks?

Ramesh Iyer: So this is a little technical. So I will only say that it is arising out of the certain variables moving towards retirees like gratuity, etc.

Dinesh Prajapati: IND-AS.

Ramesh Iyer: IND-AS, there is a lease rental...

Rajesh Vasudevan: So there are two changes, one is 116, which is effective from 1st April. So there has been a regrouping of rent into the borrowing cost and depreciation. And then we have - this year what we did is there was a restructuring of salary components internally. So what has happened is because of that, there is an impact on the gratuity provision. The basics have been increased by 5%. So that has an impact on liability of gratuity for previous years.

Abhishek: So how much was the individual impact due to AS 116?

Rajesh Vasudevan: Ind AS 116 overall, it is Rs. 80 lakhs per month is what we are getting an impact, per month, Rs. 80 lakhs. So Rs. 2.5 Crores during the quarter. And gratuity is around Rs. 14 Crores. And then leave encashment, which also gets revalued because of the basic ranging so we are around Rs. 16 Crores. So Rs. 30 Crores totally because of these two components and Rs. 2.5 Crores because of the Ind AS 116.

Abhishek: Okay. But even if I knock off this Rs. 30 Crores, Rs. 35 Crores from your overall opex, let us say, that still gives me about 35%, 36% growth in your opex.

Rajesh Vasudevan: When you see last year, last year there was a one-off item where we had written back some expense of around Rs. 25 Crores in last June, first quarter. So there was an excess provision, which got reversed.

Abhishek: So even then, the growth would be about 28% in your overall OpEx.

Rajesh Vasudevan: Of course, we have to remove. Rs. 26 Crores will be removed.

Abhishek: Yes. 20 - fair enough. So my point is that you are still growing your OpEx...

Ramesh Iyer: You are comparing last June to this June?

Abhishek: Yes.

Ramesh Iyer: Yes. So therefore you must understand the number of employees that would have got added during the year. There will be at least 4,000-plus employees we will have added during the year, the benefit of which would have come to us in the month of March. Now you will get similar benefit in this second half. I think you must understand the use of these employees are not all income-generating employees, right? So therefore, you cannot even make a percentage comparison of overheads to income. Many of them, as I said 35% of the employed force, is there in the collection, right? Not all of them are income generating. Many of them are quality correction. So one has to see the NPL reversal that happens as an outcome of this employee and that cost is towards that. Okay?

Abhishek: Fair enough, Sir. So basically, I understand that you are saying that you are investing in building that collections infrastructure.

Ramesh Iyer: Not only I am saying we are building in the investment in collection, I am saying that if you compare last June to this June, in between the number of employees added, have to be one of the factors of the increase in costs.

Abhishek: Of course, Sir, of course. So my point is still that in a period when your growth is slowing and your revenue growth will also slow down, you were having to put in extra – you are having to put in extra manpower into your business. And that is sort of increasing your cost growth to about 28%.

Ramesh Iyer: My dear friend, I am only requesting you to do not make this people cost comparison on a quarter-over-quarter because this has to be compared on an annual basis and sequential basis because these are committed people who joined us previous year and produce, they started to show what we showed in March. Now the result you will see coming next March as the whole year productivity kicks in, right? At a point in time, it appears to be higher cost because the productivity is low. But in a rural market, as the volumes pick up, as the collections pick up, you will see the productivity improvement and then the cost dropping.

Abhishek: So on a normalized basis, what kind of increase in cost, overall cost, including the additional branches or people you are going to deploy, what kind of overall increase in cost...

Ramesh Iyer: So I have always said that in a business like ours, one way to look at that is what percentage of asset is our cost. So we have always said anywhere between 2.9 to 3.1 is the cost that we incur, 3.1, 3.2 at the lowest productivity, 2.75 to 2.8 when everything is going well. And you will always see this that in the first 6 months, the cost is at that 3.1, 3.2 levels and then comes down to a 2.8, 2.9 as the whole year closes by.

Abhishek: Okay. Fair enough. And the other question that I have, again, sorry to come back to that provisioning question. But incrementally, it seems that on the 1220 Crores slippage, you made about a Rs.500 Crores provision. So that is around 40% kind of coverage. So suffice it to say that this is all based on your PD/LGD devised assumptions. So going forward, for whatever slippages happened during the year, again, you are going to have to make that much coverage? Or is that not the right reading?

Ramesh Iyer: So therefore, if you are at a certain level of NPA, our clear understanding of this business model and historically for 25 years is, you will only see this getting corrected to go downward as the cash flows of the rural starts to come in. It is always that sequentially if you look at the NPA will be higher in the first quarter. As we close the year, it will start to decline again.

Abhishek: Yes. Sorry to just jump in. I understand that part. I am just talking about the incremental, and given that now your provisioning is based anyway on your ECL methodology, on the incremental you made around 40% provision, which is you know what the ECL has thrown up.

Ramesh Iyer: Yes.

Abhishek: So whatever happens between now - whatever slips between now to March on that, also you will need to make 40% or thereabouts of the...

Ramesh Iyer: Let us say ECL changes percentage upward for whatever changes in the marketplace, right? Then on the same account, we will have to make the difference and the reverse would happen. That if the ECL calculation show a downward trend due to changing market environment or favorable market conditions change, you would get the downwards. I am saying that if this number of accounts remains in NPA and if the ECL calculations do not change with the conditions remaining the same, there is no additional provision required on these accounts.

Abhishek: Sir, the question I think most people have is that your ECL calculation itself should not be changing so dramatically because you are taking a long period to calculate your expected credit loss. Your LGD, your PD, you also said that it has gone up almost offsetting each other.

Ramesh Iyer: Correct.

Abhishek: And the ECL calculation, ECL provisioning required should not be changing so dramatically?

Ramesh Iyer: We are not changing the ECL so frequently. Please understand that when new accounts come in to NPA, by ECL calculation, we have to make upfront provision for that account fully. And that is causing this pressure. If “x” thousand – let us say Rs. 1,000 Crores of gross NPAs come in, on an ECL basis, we are required to make all the provision upfront. Now if the account moves out of NPA, we will get the benefit. If they remain - continue to remain in the NPA, we may not have to make any additional provision. The change in provision value does not come from ECL changing from 30 to 50 or 30 to 40 or those kinds of changes. They come by the new account coming in to NPA and making a full provision as per ECL need.

Dinesh Prajapati: So the ECL calculation LGD rule changes only twice a year because every June and December, we do these changes, June quarter and December quarter. So previous cycle six months goes out and the current cycle of six months gets into. So every six months we revisit this number to get it more aligned to the current situation. So that is we do every six monthly.

Ramesh Iyer: And they will not have a very dynamic change I can tell you.

Dinesh Prajapati: Yes, LGD percentage as what we spoke to, one of the questions was raised, what was the deviation for LGD, it was just 2%.

Ramesh Iyer: 2%. Because most of the factors are already considered. It is just these parameters will not change while the percentage of those parameters could slightly undergo change. Unless we get into a new class of assets altogether and then they bring in a new parameter, that is a different story, but given our experience and most geographical customer segment and product experience, this variability arising out of this will not be very dynamic.

Abhishek: Okay. So sorry to belabor the point, but just to make one thing very clear, when you say that you are providing fully for the NPA that has come up in this quarter, you mean fully to the extent that the ECL requirement throws not 100% provision.

Ramesh Iyer: No. Not 100% provision. We have requirement, lifetime number is the right term; lifetime provision. This asset remaining in our book and if the ECL calculations do not go change, we will not be required to make any additional provision.

Rajesh Vasudevan: These are the lifetime provisions.

Abhishek: You are saying fully and 100% so that could have also created, anyway, I will take up with Dinesh later. I think I need some more clarification on this.

Rajesh Vasudevan: Okay. Not problem

Abhishek: Okay. Thanks a lot.

Moderator: Thank you. We take the next question, which is from the line Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal: I am coming back to the same question. If I look at your provisioning coverage on Stage three assets, it ranges between to 31 to 36, between 1Q FY2018 to 2Q FY2019 then we dropped to 19%, then it [goes] to 24% again. So I am not able to understand that for first six quarters it was more than 30%. It went down to 19% and now it is again going to 23%.

Ramesh Iyer: So I thought Dinesh earlier explained so that you moved certain assets from there to either a termination loss or a fully write-off. Then the coverage drops and we do that write-off twice a year, one's in September and one's in March. So you will again see that, let us say, in September we move “x” percentage of this asset to a write-off category, right, either by repossession and sale or by customer negotiating and closing, whichever way it happens. Then you will find that it moves out of gross NPA and goes into termination and moves out of provision. Supposing there is no difference between what we have provided and what the loss is, the P&L will have no impact. But supposing that bunch of asset do bring in Rs. 1 extra loss, then to that extent it gets factored in our overall calculation when we reset it at a future date.

Pankaj Agarwal: So if I look at your Q4 FY2018 provisions, it was 31% on Stage three assets, right?

Ramesh Iyer: Correct.

Pankaj Agarwal: Question is why this 24% cannot go to 31%? Why do you think it will remain at 23% or 24%?

Ramesh Iyer: It can go, it can go. Why it would remain, suppose we do not have a major right off and termination and we continue to hold the provision, it will go up there.

Dinesh Prajapati: The LGD percentage is around that number what you just mentioned.

Pankaj Agarwal: Second question, Sir, though you have sequential increase in your NPAs, but do not you think the trend is higher than what you expected at the beginning of the year?

Ramesh Iyer No, In fact, if you recall, the April call that we had when we closed March, I very categorically said that it is likely to be somewhere around 7%.

Pankaj Agarwal: Okay. So now if I look at your numbers, you have seen roughly 200 basis point reduction in your NPAs on a Y-o-Y basis.

Ramesh Iyer: Yes.

Pankaj Agarwal: So would you say that even by the end of this financial year, you will see similar decrease in your gross NPA ratio looking at the trends?

Ramesh Iyer: I do not want to put a number to it, but I can very categorically tell you historically for last 25 years, the October to March collections bring down the NPA much lower than what it is between April and September. And we do not see any changing trend in that even as we speak today.

Pankaj Agarwal: Because, Sir, reason I am asking this question is that if I look at trajectory of NPAs, in entire FY2019, it was roughly 20% Y-o-Y decrease in your absolute gross NPAs. There was a trajectory you had and certainly this stopped to only 5% Y-o-Y decrease, right? And if I go back to your FY09-10 numbers, when you came out of the last downward cycle, this Y-o-Y decrease in gross NPA last year was 7 or 8 quarters, right? So I mean my assumption is that probably you might be seeing reduction in your old stock of NPAs, the similar decrease you saw in the last cycle probably might be adding some new NPAs because of the stress in the rural segment or the economy. Is it a fair assumption?

Ramesh Iyer: No. So I want to clarify to you that since the 12-month collections are managed by the business team and if I was to look at the last 12 to 15 months business done, the NPAs are much lower than historic book that we have. So that is the reverse of your thought process. But the second I want to tell you is when the gross NPAs remain at 8%, 9%, 10%, 12%, the chances of them getting corrected when the market conditions improve will be very steep as compared to when you are already at your best level of NPA. So we should not forget that 5.6% was our historic best when it comes to NPA on a 90-day basis and we did not expect that it will go down from there. It will only go up from there to start with and then come back to. This 5.6% becomes 4%, 3%, 2%. It is something that I am not wanting commit to because it all depends on how harvest, cash flow and all kinds of things turn out to. But definitely, will 7.4% climbed down barring the denominator effect, lets say that asset growth becomes negative and not growth that is a different way to look at. But absolute number of customer in NPA as of today, let us say they are at the 1.3 lakh customers are in NPA as of today, when we close March 31 of this year, I can tell you that number will be much lower than this number.

Pankaj Agarwal: Okay, Sir. Okay, Sir. Fair enough. And the third one, last question, in terms of your growth rate, how much you attributed to your liability-side issue and how much to demand-side issue?

Ramesh Iyer: I think 0 to liability-side issue. The reason is I do not think ever we are in a situation of saying we do not have money, do not do business, okay. Surely, liability side, effect will be , if somebody says I want a 10-year loan for a truck or a tractor, we will say no. Now one way to answer this is it is an asset side issue because a customer who wants 10 years, we do not want to be. Somebody may answer that is why I would have done - like to do 10-year if I could have raised a 10-year one. But those will be a minuscule percentage of the overall. Therefore, the entire growth story is purely arising out of volume from market being subdued and nothing to do with money not being available.

Pankaj Agarwal: And that you would say for the entire auto sector as well?

Ramesh Iyer: Of the industry or to us you are saying?

Pankaj Agarwal: No. I mean like auto sales are down in all the categories, right? 10 to 15...

Ramesh Iyer: My personal belief has always been nonavailability of money cannot be attributed as a reason for the decline in the auto industry. Because go and ask dealer, if the footfall at the dealership is very, very high and he is not able to convert because money is not available, then that is the reason. But we are seeing that footfall is low and it comes from exchange program being not very aggressive. It comes from sentiments not being very aggressive to say why in this turn I should buy a vehicle, why cannot I wait , right? It also comes from every two months there is a new model being launched and somebody says, let me wait for Kia to come then I will decide what to buy. By the time somebody then says I want to come with a new vehicle. So there is a postponement, which is also happening. So it is a factor of many, many things. I would think in that order, when an OEM write 10 reasons, surely he will write availability of finance. But if somebody was to put a weightage to each of this, I think finance will get the lowest ratings.

Pankaj Agarwal: Okay Sir. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, that was the last question. On behalf of JM Financial, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.