

Mahindra FINANCE

“Mahindra & Mahindra Financial Services Limited Q1 FY23 Earnings Conference Call”

July 28, 2022

Mahindra FINANCE

 **IIFL** SECURITIES



ANALYST: MR. ALPESH MEHTA – IIFL SECURITIES LIMITED

MANAGEMENT:

MR. RAMESH IYER: VICE-CHAIRMAN & MANAGING DIRECTOR

MR. VIVEK KARVE: CHIEF FINANCIAL OFFICER

MR. AMIT RAJE: CHIEF OPERATING OFFICER, DIGITAL FINANCE

MR. RAUL REBELLO: CHIEF OPERATING OFFICER, CORE BUSINESS

MR. DINESH PRAJAPATI: HEAD - ACCOUNTS, TREASURY & CORPORATE AFFAIRS

MR. RAJESH VASUDEVAN: SENIOR VP - ACCOUNTS.

Moderator: Ladies and gentlemen, good day and welcome to Mahindra & Mahindra Financial Services Limited Q1 FY23 earnings conference call hosted by IIFL Securities Limited. As a reminder, all participants' 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 touch-tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Alpesh Mehta from IIFL Securities Limited. Thank you and over to you, sir.

Alpesh Mehta: Good evening, everyone and thanks for joining us for MMFSL Q1 FY23 earnings conference call. From the management side, we have Mr. Iyer – Vice-Chairman & Managing Director; Mr. Vivek Karve – CFO for the Group Financial Services Sector; Mr. Amit Raje – Whole-time Director & Chief Operating Officer – Digital Finance Business; Mr. Raul Rebello – Chief Operating Officer, Core Businesses; Mr. Dinesh Prajapati – Head, Accounts & Treasury; Mr. Rajesh Vasudevan – Senior VP, Accounts; and Vishal. Now, without much ado, I hand it over to Mr. Iyer for the opening comments and post which we will have a Q&A. Thank you and over to you, sir.

Ramesh Iyer: Good evening and thank you everyone for joining this call. Let me first kind of start from what we saw in this quarter and what we see going forward. I think after a very very long time, we are able to see disbursements continuing to maintain growth and this is the first time that we have seen the highest ever growth in the 1st quarter of any year in the past of a disbursement and even sequential growth. That is one good news that we saw that the demand is holding up and the sentiments are positive. Inventory levels are going up but still an issue from an availability perspective, but nevertheless we clearly saw demand for vehicles, tractors, pre-owned vehicles, in all the segments that we are operating. Also, given our deeper relationships with dealers and our wanting to get into different segments in the rural market has helped us gain market share for almost all the product lines that we are in. The disbursements clearly are a good positive from what we are seeing as a growth. Also from an asset growth, therefore, we have now started seeing the AUM beginning to grow, which is after a very very long time, and all the recent past, you have seen our assets actually degrowing, but we have now started registering the asset growth. This is contributed by an overall growth from all the products that I just talked of.

On the collection fronts, we again had good traction. Even in the first quarter, our collection efficiencies were pretty good I would think. Again, this if you look at any time in the past in the first quarter, we always have had pressure of collection leading to increase in NPA substantially and very clearly, that trend has been beaten in this particular quarter, and one of the reasons for that is unlike in the past, we saw in this round the economic activity levels were pretty high; the tourism was at its best, people movement was high. I think all of that definitely contributes to a better customer cash flow which leads into a better collection for us. All of this put together, I would think that the quarter gone by has been a favorable quarter from our perspective and I think we clearly see the trends going forward to register even a better trend from what we saw in the first quarter. This was not very contrary to our belief of what we thought would happen. If you recall in the past quarters that we have been talking of, we have been repeatedly saying the rural sentiments have turned positive for us, we have seen good customer cash flow, and

therefore, our belief was that the growth would come back, and the asset quality would hold up. We have taken some aggressive stand when it comes to repossessions and disposal of vehicles and that has resulted into a little higher provision on termination that we have done. And again, go back to the last quarter that we discussed of for some high delinquent account, the repossessions were aggressively done and we have been able to transact on those vehicles and liquidate those repossessed assets, but definitely we believe that this is not what is likely to be as the year goes by because if we are today at 8% kind of a gross NPA number, we don't need to now resort to a very aggressive repossession stance. Also, it is prohibited by the fact that our Stage-2 has also come down substantially to what it was in the past few quarters. So, putting all of this together, we are very confident on how it is likely to go forward in terms of asset quality, in terms of collection efficiency, and in terms of growth. As I said, the sentiments are positive, and the contracting segment is doing well. Of course, it's a monsoon period; therefore, you will see some drag on the contracting activity, but the good monsoon is also a good indicator of how the harvest is likely to be going forward, and therefore, we are very hopeful that even the festival season will be a buoyant festival season. We are preparing ourselves for taking full advantage of the coming up festival season. Therefore, the second quarter would definitely be a positive quarter if the first quarter has gone the way it has gone and that will lead into a good second half of the year and which is where our confidence on maintaining the asset growth in the direction that we are seeing, maintaining the disbursements growth in the direction that we are seeing, and therefore, the delinquent NPA numbers would also look very different from what we are already in.

Putting all of this together, I would also like to write upfront comment on how do we see the new RBI regulation that would come out from October that we need to follow. We very strongly think that the way we are seeing correction to our NPA and the way we are seeing the overall collection efficiencies improving, it may not be very relevant to look at what the number looks like now because what is more relevant is how do we end the second quarter and how do we open up the new account going forward. Our belief is that even if we forecasted increase of 2% NPA was to happen to the IRAC numbers, we may not need to have provisions to be made at a higher level given the provision that we are already carrying. We have taken an aggressive stand to maintain higher coverage. I think we are currently at about ~58 % coverage we would continue to maintain that level of coverage in our Ind-AS and therefore the confidence that we may not require to make substantial provision going forward is where we come from. But on an overall basis, I think the sentiments are very very positive and I have been repeatedly saying that we believe for the next 3 year, it's the rural geography to watch for growth. The opportunities would be phenomenal. The infra as I said is opening up in most of the geographies. Monsoon even though it was a little delayed in UP, Bihar, Jharkhand, etc., but it has caught up and normally these states do get monsoons a little late but was not anything to be overly worried about. Now it is really a widespread monsoon and I think that should be our advantage as we see the festival season open up.

On the cost of funds, definitely we have seen increasing trend on the interest rates. We have taken one price increase of about 40 basis points or so on product, but as we repeatedly say, we will watch this space very closely and then keep increasing our rates by geography, by product

at different points of time and I think we would catch up over a period of time even through the increase in price. But it will also be an outcome of a certain product mix change, as we see, pre-owned vehicle demand being high that comes at a better yield. Tractor demand is picking up. That will come at a better yield. Putting all of that together, some correction to the NIMs will happen through product mix change, some will happen through the lending rate passing on to the consumer. But even if we were to retain some rates for some high-end customers, that would be more than offset by a low operating costs for such customers and a very low delinquency from these customers. Therefore, at the ROA level, we may not really have a much pressure because of the borrowing cost increase, and even our borrowing cost increase will not all happen at a time. It will definitely happen over a period of time as our past liability begins to mature. So, I would think very confidently of the disbursement growth happening on all fronts, clearly the AUM growth therefore beginning to happen, asset quality well under control, and our ability to maintain a high collection efficiency should all lead to better profitability and better return on equity as we pass through the quarters ahead of us and as we close the year. No pressure on liquidity. We have been sufficiently, of course, backed up with our own 3 months' stock of liquidity even if we were to face any emergency situation, but even otherwise, as we look at the market, we don't have any pressure on the liquidity front. And as I said, on the interest fronts, we are more than preparing ourselves to absorb some and pass on some. Putting all this together, we believe the year ahead for us is very very positive and if we were to look at the next 3 years ahead of us, we would feel very confident and comfortable about the way we are structured.

We are investing sufficiently in our technology space and in our data space, and I just want to take you back to the project Udaan, the transformation agenda that we talked of in the March results call where we clearly set out on how we look at the next 3 years. I think the program is well on course. On each of the front, we have taken a very deep dive understanding and initiatives are put in place and our promise that in 3 years, we want to almost double the balance sheet seems to be on course in that direction and you are already seeing the beginning of growth happening and we are confident that in the 3 years' space that we have set for ourselves, we should not lag behind on that strategy clearly.

On our various new initiatives, the first one on the leasing front, definitely we have seen good traction from the institutional requirement, more so for the CTC car, etc. On the retail, we are a little cautious. We want to make sure that we understand the residual value pricing correctly, and as we put it that in place, you would see us also in the retail space taking a better participation, but definitely leasing we believe is a future product and we see good traction in that front.

As far as our small-ticket loan, consumer durable loan, the digital initiative is concerned, that again is now well set. The space that we operated in has given us some insights and we have brought in all those inputs and made necessary adjustments to the product design that was required, and it is now beginning to pick up. It is too early days to say what the number will look like during the year. This year, we will still be setting it up and growing it in that direction, but in the 2-3 years' space that we are talking of, this will become a very key vertical to really participate on. If you recall, we had talked of new verticals that we would begin, mainly also

looking at SME and loan against property as the two-growth engine possibility. On the SME front, again we have seen tremendous traction from the Mahindra ecosystem and from the overall auto ecosystem and we are doing pretty well both on the working capital support or bill discounting backed up by the OEM support as well as on the expansion programs of the suppliers. And we would see a growth of this business scaling up well during the 3-year period. This year itself, it should do at least about 2000-3000 crores very clearly as a book as we move along in that direction.

As far as loan against property is concerned, we are first setting it up. We are putting a team in place. We have not yet begun any disbursement in that front, but I think before close of the year, we would come back to all of you and tell you how we have set it up and what is the real progress. That is not something which will add to any disbursement during the year but SME for sure would add. Leasing and Digital FinCo again may not be volume disbursement this year but will add up in the following year. But clearly, market share growth, deeper penetration, new segment of customers from the rural and semi-urban segments what we call as affluent financing, all of that will definitely add up to the overall growth. Fortunately, we are seeing growth potential from all fronts – whether it is in the auto front, whether it is in the car front, whether it is tractors, commercial vehicle, pre-owned vehicle – in all the fronts, we are seeing good traction and good positive demand that we are seeing very clearly. And that gives us confidence that the festival season and run up to March closing will be an excellent 6 months to watch for.

Putting all this together is where comes our confidence of what we think the year will look like and what we think the 3-year strategy that we have put out would look like. I think we are very comfortable to make a commitment that we are in line with our commitments that we made earlier, and we believe that we would be able to achieve those targets as we have planned for doing that.

I would stop there and then invite questions from all of you. I think we will then holistically cover what the intent and the direction is. Thank you.

Moderator:

Ladies and gentlemen, we will now begin with the question & answer session. We will wait for a moment while the question queue assembles. The first question is from the line of Mahrukh Adajania from Edelweiss. Please go ahead.

Mahrukh Adajania:

I have three questions. Sir, my first question is on provisioning. How do you think we should look at provisions? You did say that you had an aggressive repossession policy and a lot of it may be behind us. So, how do you look at provisions or credit cost? Could you then forecast in the next few quarters that if the macro environment remains as it is today, then your next quarter's credit cost would be 700 minus your repossession losses. Say if your repossession loss is 300 crore odd, maybe it comes down to 50 to 100 crores and then we are looking at a 400- to 500-crore run rate of provision because that's the most confusing part right now. How could you forecast your provisioning?

Ramesh Iyer: Let me first clarify this question to you before you go to your second and third. I think very clearly if today the credit cost taking all the elements of provisioning as well as termination loss and disposal loss, all that put together if there are at about 3.2 to 3.3 type number, we would clearly see at least a 1% correction to this number in a year because this is not the same level of repossession that we will be required to do in the future quarters. Because this was required to be done from the level of NPA that we were in and as we were correcting it and as we saw the Covid impact on certain segment of customers who either wanted to surrender the vehicle or move out of the business, we did resort to settlements, and we did resort to taking back of the vehicle. I think those elements are all done with. So, clearly one should look at ending of the year as we pass through the next 3 quarters, you would see this climb down at least by a percent from where it is today.

Mahrukh Adajania: Sir, my next question is on margins. How do you see the outlook on margins?

Ramesh Iyer: As I said, fortunately the entire new borrowing cost is not going to impact us almost immediately. It will impact us over a period of time, and we would catch up by our lending rate moment as well. As I said, we have already passed on 30-40 basis points through our lending rate, and we would continue to watch that space and keep increasing the rate in line with the borrowing cost increase that are witnessing. So, truly, I don't think we should have a huge pressure on the margins as far as through the borrowing cost is concerned. But you will see some compression of the NIMs happening because that is also a product mix change that will happen which means when we get into a little high-end customer, definitely the rate at which we would do business with them, the yields will be different from other segment of customers. But that should then reverse back itself through lower operating costs and a lower delinquency. So, you may see some compression on NIMs coming through our product mix change, but it will also be to some extent offset by the change in the pre-owned vehicle financing or tractor vehicle number going up. Put these two together, we should see itself offsetting to some extent. And the borrowing costs as I said would be offset through the lending rate. There could be some lags for sure. We can't simultaneously pass on all borrowing cost increase unless the market responds to it in some form. So, there could be a quarter, or two lag effect will be there, but if you were to look at the year-end number, you may not see a very different NIMs number from where we are.

Mahrukh Adajania: Sir, my last question is you have seen good growth traction right now. You said festival season will be good. That is one part of the story. On the other hand, we are faced with a global macro slow down, but given the segments you are in, those remain unaffected by that narrative, correct? So, the growth outlook for the next 3 to 4 quarters or say 3 to 5 quarters according to you should be good enough coming off a low base of Covid?

Ramesh Iyer: Yes, surely. As of now, we don't see any reasons to relook at our disbursement targets. We are pretty confident and let us not forget that surely there will be a price increase from OEMs which will come through in the next couple of quarters and that would be an added support to the overall disbursement number. First is, we don't see any volume pressure that we will not be able to get those numbers and inventory levels are improving and demand is definitely positive. Add to that, there will be a price increase from OEMs which will also be a good support to the increase

in the overall disbursements. So, at this stage, we are not relooking at reversing our number downward on the disbursements.

Moderator: The next question is from the line of Rikin Shah from Credit Suisse. Please go ahead.

Rikin Shah: I had a few questions, a couple of them relating to the medium-term strategy. First, when we talk about NIM compression due to a product mix, is it a customer mix or a product mix? And when we speak about the rural affluent category, I believe the yields are closer to 10% versus our current book yields of 14-15%. So, how does one expect the overall yields to trend over say 2 to 3 years and not the near term? That's the first one. Second one is on Opex. While we have talked about reaching Opex of 2.5%, currently it was elevated and much higher than expectations even in the quarter at 3.2%, what is the cost efficiency measures that we can undertake to bring this back? Thirdly, the question was also relating to housing business where we saw the NPAs again going up from 11% to 14-15% in the quarter sequentially. Any color there? And last question is on the deposits. We have seen the last 4 to 5 quarters of sequential deposit contraction. Is there any rethink in terms of how we want to set up our borrowing mix?

Ramesh Iyer: I will try and answer them, but I don't know if I would remember all four questions. First is on the NIMs. Clearly, when you ask whether it is product or customer, first of all it will be customer because when we look at affluent financing that is high-end customers of rural, that's one from where we will get a little pressure on the yield. Like you said, they are low yield, but they are not going to be a very large number which will tilt the whole balance. The other element of the mix change is the product mix change which is when you have a higher disbursement in pre-owned vehicle and higher disbursement in tractors, they are definitely high-yield products and therefore that will give us an advantage of the margin improvement and not margin shrinkage. Therefore, you must look at it from both angles. One is, there is a segment that we are adding which is a low-yield segment, but that's not a very large number in disbursement, and second is the product mix change which will definitely be a beneficial product mix change when we do pre-owned vehicle as well as tractor a little more than what is happening now. That's on the product front is concerned.

The second, on the Opex cost that you talked of, we have sufficiently invested and there are definitely some advance investment that is happening. When you take people and when you invest in technology, all that doesn't come off immediately in one quarter, but if you see the way the asset is growing and the disbursements are beginning to happen, you will see definitely this cost climbing down with the asset growth happening and we are not proportionately going to keep investing more and more. The only cost that will keep coming for the growth will be the variable cost which will be directly proportional to the disbursement that is happening, but on the fixed cost front, whether it is on the people front, whether it is on the technology investment front, etc., I think we would have more than done enough for gaining the growth that we are looking for which is where the confidence that if the asset starts to grow well and even if it goes up to a 15% or 20% kind of a growth over a period of time, we don't have to substantially invest to achieve that and that's where you will start seeing the costs coming down.

So far as the housing NPAs are concerned, that's typically the business where 1st quarter increase is happening unlike in Mahindra Finance where the trend changed because of the earning assets doing better whereas the housing assets are still dependent on their different sources of revenue which is more farm-related revenue, etc., and their trend couldn't change in the 1st quarter. And that similar trend of what we have seen never in the past continues to plague them even in this quarter. They will also correct themselves in the third or fourth quarter like typical correction that happens. In spite of that, they are at a little elevated level. They are also looking at their book very very closely and we will take some very aggressive corrective stand on settlements with customers, etc., because what we have seen is the last 2 or 3 years that whatever businesses that have been done, they are at a much much lower level of delinquency. Some of these delinquency are struggling which are of our very initial days when we set up the rural business and it was kind of an experimentation that we were doing on the low-cost lending there and that got us some quality issues and therefore a close look at that and some corrective actions will be put in place, and you will see that happen in the next 2 or 3 quarters.

Rikin Shah: The question, Vivek sir, was pertaining to the absolute levels of deposits in the balance sheet that have been coming off in the last 4-5 quarters. Is that intent a planned reduction or there is something more to it?

Vivek Karve: It is not a planned reduction. Fixed deposits continue to be an important source of funds for us. We have recently taken up our rates also in the fixed deposits by almost 70-75 basis points and therefore we expect the flows to start trickling in once again.

Rikin Shah: Any reason why it was contracting for the last 4-5 quarters?

Dinesh Prajapati: During the Covid period, there was accelerated deposit flow in the FD. As the Covid situation eased out, because of the rates remaining competitive at the market rates, the flow in the FD reduced which led to a drop in the FD deposit base. However, as we now once again have started raising the rate, we believe that the flow will start improving further going forward.

Vivek Karve : Also, what happens in FD also needs to compete with other sources of funds. If the other sources of funds are available in plenty, we would remain selective on increasing our FD rates, but with the inflationary pressure, which is seen across the sources of funding, we believe FD should start increasing slowly as a share in the overall borrowing mix.

Rikin Shah: Just one last clarification question for Iyer sir. In your opening remarks, you mentioned that to comply with the RBI norms, we may not need to take substantial provision. In the last quarter when you mentioned we may need additional 500 to 1,500 crores of provision, how do we reconcile between the two? Now are we confident that we may not need any additional provisions?

Ramesh Iyer: A little premature to make the comment, but when I said we may not have to take substantial, you can discount that the 1,500 may not be the requirement for sure. And then, as I told you about the example, if you were to go up in NPA only by 2% and if you have to maintain a net

6%, if you compute it, you will see we are not required to make any provision because we are carrying substantially a high provision in the book already. Our endeavor is to make sure that by September, we do bring down these NPA numbers to a much lower level and therefore ensure that the requirement of provisions is very very limited, but I think if you give us some time to get a much better color, maybe we will do a specific call sometime in September to let everyone know how things look like. At this stage, our projection is that we may not be required to take a very high hit in the last quarter.

Moderator: The next question is from the line of Abhijit Tibrewal from Motilal Oswal. Please go ahead.

Abhijit Tibrewal: Again a question on asset quality and the write-offs that we have been taking. While we keep saying that some of ECL provisions on the balance sheet have been coming down, but a large part of the P&L credit costs that we have been taking over the last few quarters have been because of write-offs. We have already taken around 4,700 crores of write-offs over the last 2 fiscal years which is FY21 and FY22. In this quarter, we had another 570 crores of write-offs. So, basically is there a way to give some kind of guidance or what kind of write-offs that you are expecting maybe in this fiscal year? Secondly, from what I understand, we have not implemented RBI NPA circular as yet in our books of accounts while everyone else has done it. So, don't you think that given that you have not implemented it, customers have not had the time to kind of tested to the new RBI NPA norms and you will probably have to go through the same grind again to discipline them to tell them that they need to pay their installments on time? Lastly, for Mr. Vivek Karve, what is the quantum of increase in portfolio borrowing cost that you are anticipating maybe over the remaining 9 months of this fiscal year?

Ramesh Iyer: So far as customer education is concerned, right from the time the circular has come, we are already on the job and we are continuously communicating to the customer, meeting the customer, and we are seeing definite movement positive in the direction of the ability to collect on or before the due date kind of a situation. I don't want to comment on everybody has moved to this. There is some comment that you made, I am not too sure, but that is not the point of debate at this stage. But honestly speaking, when you need to do it only from October, moving it now does not really make any big difference or sense because at the end of the day, 30th September whatever will remain in your NPA is the one which you will have to collect all installments before they can come out of NPA, and from 1st October, you must make sure that your forward flow is substantially arrested. If you look at our efforts and see it from the Stage-2 numbers, you will see that there is a continuous improvement to the Stage-2 that is happening, and we would like to keep the Stage-2 improvement continuing so that we are able to hold the customer at that level and not allow them to forward flow. The challenge in the new circular is, when you allow them to become an NPA, you can't reverse them unless you collect all the installments and bring them to zero. Therefore, the education, the effort, the internal systemic change, contract allocation to field executive for collection, all of that is aimed at ring-fencing the contracts from a forward flow from Stage-2 to Stage-3. That is where the confidence that we have to believe that why we may not be required to take a higher provision because we, I think if I'm not wrong, in the first quarter of last year when we entered, we had a Stage-2 level of upward of 19 odd percent or so. That we have brought it down to now close to about 12% or so

and our endeavor is to keep taking it even lower so that we have a much lower problem to begin with. Similarly, from a gross NPA perspective, if we are able to bring it down to a level lower than where we are, then that further reduces our problem to address this. So, you must please look at it from the efforts producing what kind of a result and therefore the confidence as to why we would not be required to go in that direction.

As far as your write-off question is concerned, we made this statement even in the last quarter, etc., that we have assessed various customer segments and someone who have been severely impacted because of the Covid and if we think that it is difficult for them to move out from where they are, we have taken a view to make a provision like we moved out, if I am not wrong, 100% provision thing to 18 months and below and we are continuing to move in that direction even in this quarter. So, in this business to a higher provision and remain provided for especially when you have substantial capital support as well is always a good thing because then you can put more efforts through a specific action around these contracts and you can have better recoveries happening. Now, to your point of first quarter if we have had some 500 odd crore provision, is that the same number we are going to look at in each quarter, my clear answer is no. I think someone asked this question even in the first round and our answer is very clear that we don't need to resort to same level of repossessions that we had in the fourth quarter and the first quarter. That's not the kind of number we will need to look at for the next 3 quarters. Therefore, you will see a lower provision that we will be required to make on the front of write-offs, and you will also see some recovery that is beginning to happen from all the provided accounts. That will be a good net off that will be available to look at.

On the third question of funding, Vivek, will you take it?

- Vivek Karve:** It is a difficult question to answer because it also depends on what further action does RBI take. But our assessment is that compared to the levels of the weighted average cost of borrowing that was there as of 30th of June, for the rest of the 3 quarters, we may see maybe a 50 to 60 basis point increase. But it is completely a function of what actions does RBI take from here onwards which in a way is also a function of how the Fed reacts.
- Abhijit Tibrewal:** Sir, this 50-60 basis points is assuming there are no more repo rate hikes?
- Vivek Karve:** No, this assumes further repo rate hikes. Right now, the repo is about 4.9. We are expecting at least a 50 to 75 basis point increase – if not in one shot, but maybe at least in a couple of tranches.
- Abhijit Tibrewal:** So, assuming another 50 to 70 basis points increase, we are expecting weighted average portfolio borrowing cost to increase by 60 to 70 basis points is what you said?
- Vivek Karve :** 50 to 60 is a very ballpark estimate I am sharing with you.
- Dinesh Prajapati:** We have some advantage of PSL and we have factored that, and based on that, this is what is we estimate.
- Moderator:** The next question is from the line of Sharaj from Laburnum Capital. Please go ahead.

- Sharaj Singh:** Sir, my question is from the SME book. The book has grown to around 1,500 crores while the disbursements are around 750 crores quarter on quarter. Is there some reclassification here – SME and other part of the book?
- Vivek Karve :** No, because SME and others is also.... There are elements of our Digi FinCo business, elements of our leasing business will all be there, right? The bill discounting disbursements are also not counted there. We will supply this information offline to you.
- Sharaj Singh:** Sir, regarding the write-offs, do we have a specific criteria for writing-off a loan against providing for the same or how does this happen?
- Vivek Karve:** We have a board-approved policy and as per the board approved policy, any exposure whether live or mature which is outstanding for more than 36 months overdue is an exposure which is written-off in the books of accounts. Of course, it is a technical write-off. We continue to put in all efforts to recover monies from these accounts which are written-off. And this will definitely once we write it off, then it will form part of the write-off line item. And Mr. Iyer also alluded to 100% provisioning that we have done for all 18 month plus DPD contracts. They continue to be part of the gross NPA. They are fully provided for. And the 100% provision that we carry on this portfolio is nothing but the overlay that we are carrying on the balance sheet.
- Sharaj Singh:** Could you give the NPA numbers as per the revised RBI circular? It is not implemented yet but some number?
- Vivek Karve:** There is a reason why we have not disclosed it because as you know these provisions will become applicable on 1st of October. Therefore, what is more relevant is the situation or position as on that particular date. And as Mr. Iyer said at the beginning itself that we have already initiated efforts to control these NPAs and we believe that the favorable outcome will reflect in a much-reduced level as on 1st of October and therefore the number as on 30th June is a very theoretical number and that is the reason we have not disclosed it.
- Sharaj Singh:** Can we expect further write-offs for one more quarter given that we would like to get that NPA number reduced?
- Vivek Karve:** As I mentioned earlier, our write-off policy is a board-approved policy and is followed in a very clinical way. The RBI NPAs are those NPAs which become 90 DPD, probably come back below 90 DPD but have not paid all the overdues and hence they need to be reclassified as NPAs. There is a difference between the exposures that we are writing off and the IRAC NPA. Hope, I am able to explain this.
- Sharaj Singh:** My basic question was, effectively what we will try is, as on 1st October, we will have to reduce the GNPA number to the lowest amount, right? Because those accounts will be hard to get back post the new norms commence. So, there, is it logical to have some excess write-offs to get that number lower as on that date?

Vivek Karve: That is what I am saying. It is not about write-offs. It is about controlling those overdues and trying to bring them to zero DPD, so no overdues.

Ramesh Iyer: Just to explain to you, if you are willing to take a write-off, then we can as well make provision under IRAC also. That is not the approach. It is not about writing it off and keeping the NPA low. It is about having a correct level of closing NPA by efforts of recovery, repossession, settlements whatever that we will do. If we just write-off and bring the gross NPA down, what's the problem in just keeping it as an IRAC NPA and making the provision? The effect on the P&L is the same. So, that is not the approach. The approach is to efficiency-wise do better collections from them, settle accounts with them, repossess and settle with them if necessary. But, I am reemphasizing, more importantly, under the new rule, you should have many contracts moving towards Stage-2 and Stage-1 and control them there and not allow a forward flow and which is where the confidence of high collection efficiency which leads to reducing Stage-2 from what it was to where it is today and increasing our zero bucket and Stage-1 bucket. That is the attempt that we are making, and which is why we keep emphasizing that putting out a number now will be very theoretical. Once we finish with these actions as we reach September, I think we will be much much clearer to say what it will look like.

Moderator: The next question is from the line of Manan Tijoriwala from ICICI Prudential AMC. Please go ahead.

Manan Tijoriwala: I have a couple of questions. I was just running on numbers. The SME business has seen a decent bump up. Basically, what exactly is the flavor of the lending that we do under this segment?

Ramesh Iyer: I think Raul is on the call. He will explain to you in detail. But we stick to definitely the overall auto, agri ecosystem when it comes to Capex and things like that. We have looked at bill discounting opportunities from the Mahindra ecosystem and similar like Mahindra ecosystem as well as we have just about started some lending to well-rated NBFCs as refinancing, a very small portion yet.

Raul Rebello: The SME composition includes like Mr. Iyer said, we have the traditional short-term loans that we classify as business and retail enterprises and this is largely done in the auto ancillary, food/agri processing, and engineering space. We continue to do that, and we have increased our distribution. We were, in fact, not in many branches where we also offered our other auto products. We have increased the strength of our SME team and large amount of the growth we are seeing because of an increase in manpower and distribution capabilities. Second is, our bill discounting volumes have gone up quite recently and that is largely again on the auto ancillary and within the M&M ecosystem. The third business which we recently started, and Mr. Iyer alluded to at the start is the LAP business. We have the policy in place when we have just started in Q1 which is seeing some encouraging volumes pick up. It's again secured business. So, that's the business which is incubated. And lastly, we have a line of business which is very well-rated NBFCs. It is a new business which is just started right now, very small steps here too.

- Manan Tijoriwala:** The new businesses that we are discussing, they don't form any significant part of this portion right now?
- Raul Rebello:** These are all our growth engines and all of them are adding up because as I mentioned, in our organic businesses also, volumes have started to sequentially increase because of the investments we made last year – we started investing in manpower last year – and that volumes are starting to show now in Q1.
- Manan Tijoriwala:** One question on the tractor segment. What would be the average yield in this segment? What is the collection frequency? How is the EMI structured?
- Raul Rebello:** We don't publish yields product by product. So, I'm not going there. When you talk about the collection frequency, we have a decent pool which is on a monthly EMI and wherever we give wherein the cash flow from the customer is largely linked to a crop pattern, we do factor that and have a 3- to 6-monthly interval for repayment.
- Manan Tijoriwala:** One last question. On this IRAC provisioning versus the Ind-AS provisioning, when we will come to the date when we have to compare and figure out how much provisioning that needs to be done additionally if at all? It will be compared on the entire stock of provisioning under Ind-AS versus IRAC or do you think it should be under the Stage-3 versus the GNPA provisioning that will be compared?
- Ramesh Iyer:** It's a grey area. We will have to look at both and then wait for the regulator to respond.
- Manan Tijoriwala:** When in December you had disclosed the difference between your IRAC GNPA and the Ind-AS Stage-3 was 6 percentage points. Do you think this number should come down meaningfully – the spread between the two?
- Ramesh Iyer:** Yes, we are already seeing that.... That is why I said it is not meaningful to put out anything now. I mean, on that day, even our normal gross NPA was much higher, right? That itself has come down now to 8%. So, you will see a simultaneous reduction and the gap going down as well.
- Manan Tijoriwala:** So, it could be fair enough that this 6% could even halve as a difference between the two, right?
- Ramesh Iyer:** Yes. That is why I am again and again guiding everyone to look at the Stage-2. The Stage-2 was very high. One would always imagine that the forward flow from there will happen. As you see, due to collection efficiency, Stage-2 reducing continuously gives all confidence to believe why this gap should be much lower.
- Moderator:** The next question is from the line of Piran Engineer from CLSA. Please go ahead.
- Piran Engineer:** Just a couple of numbers clarification. Firstly, was there any one-off in interest income this quarter? Is now adjusted for the interest reversal had last quarter, why has the top line declined when the loan book has grown?

- Vivek Karve:** Piran, your observation is correct, but you have to look at it in the context of the extent of reduction in the gross Stage-3 in Q4 and a small increase in the same Stage-3 level in Q1. As you would know that when there is a reversal in Stage-3, on the net basis, the interest gets accrued under Ind-AS which got accrued in Q4 and because there has been marginal increase in the gross Stage-3 in Q1, to that extent, there would have been a reversal of that income in Q1. These are running in different directions and that is the only primary reason why you will see a movement of about 100 crores after you adjust for the excess interest hit that we took in Q4. However, at the core level which is at IRRs that we charge to the customers on a portfolio level, there has not been any material difference between Q4 and Q1.
- Piran Engineer:** Just to clarify, the write backs will be 3 months sought of interest, right?
- Vivek Karve:** Yes, but you should look at the extent of the reduction from December last year to March last year. That was quite substantial.
- Piran Engineer:** Which was 1,000 crores and if I assume an average yield of 15%....
- Vivek Karve:** No, it was more. It was almost 2,700 crores, Piran, from December '21 to March '22.
- Piran Engineer:** But under Ind-AS, you have to anyway do it on the positions, right? You don't do it on the entire....
- Vivek Karve :** No, we have to do it on the net basis only.
- Piran Engineer:** Exactly, only on the provisions. The provisions have declined by 1,000 crores. That can't lead to 100 crore quarterly interest income.
- Vivek Karve:** No, it doesn't work that way. Maybe we can take it offline, and we can explain to you. But that is the primary reason.
- Piran Engineer:** My next question to you is, on an absolute basis, can you help us how to model Opex for the rest of this year?
- Vivek Karve:** Absolute basis, it will be difficult, but we can give you the guidance on Opex as a percentage of the loan book. And that is something which we have already stated when we had met after the Q4 results wherein we said that you can expect a slightly elevated level of Opex in and around 3%. I think that's what we had mentioned.
- Piran Engineer:** But that really means you have to reduce Opex a lot because you are already north of 3.5.
- Vivek Karve:** Yes, there are always some phasing issues, Piran. The balance sheet growth to that extent will also act as a hedge against the higher percentage in Q1. There are upfront investments we make in Q1. So, there may be a one-off which may not have been incurred in the rest of the year.
- Piran Engineer:** So, you are confident that this 3% target will be met?

Ramesh Iyer: The only way I would like to put it is for further growth of the book, we don't need to incur any substantial additional cost. If any, there will be a little variable cost that will come with volume, but all the required fixed cost whether it is for branches, people, technology, all of that would have been almost incurred. Therefore, the growth of the book will not come at the same proportionate increase in the cost that will continue to have.

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

Nidhesh Jain: There are two questions. Firstly, on the IRAC norms. When we move to IRAC GNPA from 1st of October, will it be on incremental basis that the loans which will slip into 90+ post 1st of October only those loans there will be differential in GNPA plus Stage-3 or it will be on the stock of book?

Vivek Karve : It will be like this that those NPAs which are 90 DPD+ as on 30th September will continue to be called as NPAs under IRAC till such time all the overdues are repaid. That is the first part. The second part is, those exposures which are below 90 DPD as on say 30th September and get into or slip into 90 DPD+ on 1st October, the moment that happens, they are tagged as NPAs, and they are upgraded if and only if all the overdues are repaid. Today, that is not the scenario. Today, the moment it comes below 90 DPD, they move out of NPA, but come 1st October, they will have to remain in that NPA bucket.

Nidhesh Jain: Which means that starting number as of 1st October is the gross Stage-3? Gross Stage-3 and GNPA IRAC will be same on 1st of October and then it will divulge over a period of time?

Vivek Karve: You are precisely correct.

Nidhesh Jain: Sir, if we look at the total write-offs which happened in the last 9 quarters post Covid, it is almost 8% of the opening March '20 AUM. This number is pretty large in my view if I compare it with let us say some of the unsecured segments. They have also seen 10% sort of write-offs. So, what should we think about these write-offs? Is it the actualized cost that will be borne, or we expect some recovery from that over a period of time?

Ramesh Iyer: Like Vivek said in between, these are formula-driven write-offs that we take and definitely there are efforts to even to recover and currently we are I think around 20-25 crores a month that we recover from them and that's now a separate vertical which is focusing on to even recover better. Now, in the last 1 or 2 years when these write-offs were taken, we didn't have the ability to go back and recover from these customers these bad debts because of the conditions that we were all in. Now with the cash flow improving, people able to travel, meet people, people are earning, all kinds of things happening, you will definitely have to expect that there will be a write back coming from them or in the sense recovery coming from them. And that will to some extent offset this. Second is, the termination losses that we incur, you will see also improvement in the resale price that will begin to happen in good times and that by itself will stop dropping the termination losses that come in. So, you have to look at both of those. First of all, do we require to go out and repossess so many more vehicles like we did during that period? The answer is

clear no. Is there a possibility to recover some of the write-off amount? The answer is yes, like 18+ provide that we make and then we write-off. We are not in the nature of nothing going to be recovered from them. The underlined vehicles are available, we will repossess them. And if we were to repossess those and sell, there is no further provision required. In fact, it will be a write back. You will see some very differential action that comes through on these write-offs and provided accounts. So, you may not have to necessarily see it in the same way that we saw the last 2 years. The last 2 years have been a very abnormal period where even many people who suffered from wanted to surrender the vehicle and get out of the business. And that is not the trend that you would see in all the portfolio.

Nidhesh Jain: Any estimate from this write-off pool, how much could be covered?

Ramesh Iyer: It will be a very wild guess. I don't want you to hold me to that, but I think clearly a 300 crore, 350 crore kind of a number to start with is what we are focusing on and then it will only keep enhancing from there based on how we see it. We have put in a legal effort around that. We have put in a separate vertical around it. So, take this as a guess number now, but maybe another 3 months or 6 months, we ourselves would like to refine this number in a direction.

Nidhesh Jain: One followup on the first question is that if the calculation is that the starting GNPA will be the same on 1st of October, then why would we require additional provision? Already the net NPA is 3.5%. It may further decline from less than 3.5%.

Ramesh Iyer: No, the additional provision was talked of from an IRAC perspective, and under the IRAC perspective, if we were to imagine that the gross NPA was to go up and to maintain a net 6% under IRAC versus under Ind-AS provisions that we have made, if there is any gap between the two, that difference will have to be provided.

Nidhesh Jain: But sir, it looks like there should not be much difference.

Ramesh Iyer: That is what I am explaining that we may not require to have a big difference the way we see our gross NPA settling down and the way we see our Stage-2 settling down. That is why we are not putting out a number on today's business. We want to see it through this a couple of months and then put out a number to say what the reality looks like.

Moderator: Ladies and gentlemen, we will be taking the last question that is from the line of Sanket Chheda from B&K Securities. Please go ahead.

Sanket Chheda: Sir, my question was that this reporting requirement of say 6% or reaching 6% net NPA, wouldn't it be a year-end requirement under PCR threshold?

Ramesh Iyer: Yes, it would be a year-end requirement, but as a company, we would like to see it from whenever it needs to be implemented.... because nobody clearly knows the response of a regulator when they start reviewing you or inspecting you. They can tell you it has to be quarterly; they can tell you it has to be yearly; it can be half yearly. There is nothing that is very hard coded on that. The current belief definitely is that it is to be at the year-end because that's

the time they would review you to give you a direction on what you need to do. If you have to move in that direction, it is better to start from the time the rule comes into play anyway.

Sanket Chheda: Hypothetically, suppose if say in October, that number is 7%, we will provide that 1% or we can see for another 2 quarters which are usually stronger in recoveries and then look for providing in Q4 or rather we will do it in October and then reverse?

Ramesh Iyer: There are two areas on which clarification would be required. 1) Will the entire provision that you carry under Ind-AS whether Stage-1, Stage-2, Stage-3 all together is what they will look at it to arrive at the difference or only Stage-3 will be looked at is one question that requires some understanding. 2) If it is only a year-ending position, then whether you need to do in that October. These are a little premature, but we would definitely set out and we will tell everyone in that quarter that if we were to make a provision, what it would look like, or if we have already provided, we will say what is that additional provision; which is why we are again saying putting anything out on the basis of today's number will be a futile exercise because this is not the number that we are looking at it will open up on 1st October. It is just a theoretical exercise this is.

Sanket Chheda: But as of now, the understanding is that 6% NPA is the year-end requirement. Is that right?

Ramesh Iyer: That is how RBI will look at it. Again, I don't have a clear answer on this because I don't think they have said it from when you need to do. They have just said it is postponed to October.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Alpesh Mehta for his closing comments.

Alpesh Mehta: Before we close, I just had one more question related to the previous question. If we are carrying the additional provision under Ind-AS of around 1,850 crores, can we use this for the additional requirement under IRAC? And in case, there is a shortfall, can we route the provisions through balance sheet? That thing is allowed, right?

Ramesh Iyer: That is allowed but I think that's not what we would do. If we have to make whatever little provision if it does come to that.... because you offhand asked the question, I am making an offhand answer. I would prefer that it routes through P&L rather than directly to the balance sheet. Again, I don't know if Vivek has a view on this, but that's the way I would look at it. But as far as provisions that we are carrying is concerned, definitely all provisions that we have at least on Stage-3 whether additional or whatever will all be considered for this offset purposes.

Vivek Karve : The question was whether Stage-1 and 2 excess provisions in Ind-AS versus IGAAP whether they can....

Ramesh Iyer: That I said even in the previous question. That's a grey area. We will have to test it out. We will have to talk to RBI. Then, we will have to take their input and then only decide which way because we don't want to be caught on a surprise by deciding on our own.

Alpesh Mehta: Vivek, sorry to harp on this point again. Even if I look at the Stage-3 provisions, we are almost 1,000 crores excess versus IRAC requirement which is almost 1.5% of our book. Even if I were to assume that your gross NPAs will go up by around 4% and you wouldn't need to put whatever 35% to 40% kind of IRAC requirement, then this provision should be sufficient, right? Then, there should not be any major hit.

Vivek Karve: You are precisely correct. You are right.

Alpesh Mehta: Thank you Mr. Iyer for allowing us to host this conference call. Thank you everyone for joining this call.

Moderator: Ladies and gentlemen, on behalf of IIFL Securities Limited, that concludes this conference call. We thank you for joining us and you may now disconnect your lines. Thank you.