"Mahindra & Mahindra Financial Services Q2 FY2020 Earnings Conference Call"

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MODERATOR: Ladies and gentlemen good day and welcome to Mahindra & Mahindra Financial Services Q2 FY2020 Earnings conference call, hosted by IDFC Securities Limited. As a remainder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during 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 Ms. Mahrukh Adajania from IDFC Securities. Thank you and over to you Madam!

Mahrukh A: We welcome Management team of MMFS and thank them for giving us the opportunity to host this call. We have with us Mr. Ramesh Iyer, Vice-Chairman & Managing Director; Mr. V Ravi, Executive Director & CFO; Mr. Dinesh Prajapati, Senior VP, Treasury & Corporate Affairs; Mr. Rajnish Agarwal, Executive VP Operations, Mr. Dharmesh Vakharia, CFO, Mahindra Rural Housing Finance; Mr. Vishal Agarwal, Treasury and Investor Relations; Mr. Rajesh from the Accounts team. I now hand the conference over to the management team. Thank you.

Ramesh Iyer: Good morning, and thank you for joining the call. I am sure by now you must have seen the numbers so I would not really deal with the numbers in detail, but we can take it through Q&A as it comes, but just on the highlight of the numbers if I have to tell you on two things. One, we have taken an additional provision of about Rs.40 Crores mainly looking at the environment, we felt it prudent to take that additional provision, and two in view of moving into the new tax regime there has been an impact on the post tax arising out of resetting the deferred tax asset. So these are the two kind of I would think, an addition that has happened to the numbers this time, but more to deal with how we look at the overall environment and what do we see for ourselves going from here is what I would like to deal with.

Just to kind of speak more specific about the quarter gone by, as all of us know I think it has been a period where the monsoons have been extreme and therefore there has been loss of man days during this period, especially in the large markets like UP, Bihar, Maharashtra, MP if one were to take. I think quite a number of days were lost on account of rains continuing and therefore the overall performance needs to be also looked at from those kind of an event, which is causing the pressure in the system. I think the other to look at is, the overall auto, tractor industry has been going through a little pressure time and obviously that has the impact on how much can an enabler like a finance company or a bank do to get benefit out of this, but the good news parallelly is that in the rural market we continue not to see too much of competition and we have been able to gain some market share in some of our products, but to speak specific on any one product, I would think the heavy commercial vehicle seems to be a little more under pressure than any other product is and that is reflected in the growth rate for that product and it also reflected in the sentiments from the ability to operate the capacity that each operator has build around their own businesses. So we believe that the commercial vehicle segment will continue to remain under pressure until the overall economic scenario improves, as also, until such time the government release of payment does not happen the contracting segment possibly will remain under pressure.

For a company like ours, we continue to maintain a multiproduct approach and we think our growth engines would come from pre-owned vehicle as a segment, which has shown a positive trend for us. It also comes from gaining of market share in products like non-Mahindra tractor, we have been able to gain some market share, while in the Mahindra segment we have marginally moved up our market share, but the non-Mahindra tractor and the pre-owned tractor financing is one of the segment that has helped us maintain some growth in the tractor segment.

So far as the car segments are concerned, while the Maruti numbers are under pressure, but we have been able to gain some market share in the rural market, but more importantly we do see many other manufacturers reaching out to this market and little volume from all of them is the other additional story that we clearly look at. So we would continue to believe that given the rural sentiments at this stage, the volumes will continue to remain under pressure, but again, as we look at the festival season, the news from the market is that the Dussehra has been average or above average and the same is expected when we talk of Diwali - Dhanteras, but I would not want to look at that as a permanent correction to demand. That would be the temporary demand increase that will happen during the festival season. So one could expect some better volumes for this quarter, but that is not something that we would like to bet on to put forward to say that is a new growth kind of trend that one may want to see.

We would continue to believe, as we set out at the beginning of the year, where we said, asset growth could be anywhere between 15%, 20%. I think we continue to believe that could be maintained for the year, but it would mean increase in volume, but the value increase will not that aggressively happen with commercial vehicle segment going a little slow.

So far as the collections are concerned, I think our understanding is, there is cash flow in the rural market, but the customer sentiments being weak, they are deciding between consumption versus liability discharge. We have seen that the customers choose to repay installment rather than add asset and that is reflected in our collection efficiency, that is reflected in our NPA maintenance. Normally the first and second quarter, historically has been where the NPA starts to build up and then the third and fourth quarter is where we see the correction, but if you see in this year, both the quarters, first and second quarter, the growth in NPA has not been as aggressive as it used to be in the past. As a matter of fact, in the second quarter, the NPA numbers, by number of accounts, is almost similar to where we were as we close June 30, 2019, maybe about 5,000, 7,000 accounts higher and the gross NPA reduction one see is also from the overall collection efficiency that has been maintained, but if you kind of just specifically look at the provision numbers that in the P&L for this quarter, it is also reflected or it is coming from the second bucket where there has been a moment and there has been a provision, which has come into the P&L this quarter, but on the pure Stage 3 account, I would think the provision numbers are curtailed to around Rs.80 odd Crores and not more than that. So to that extent, we feel comfortable and happy to make a statement that the next two quarters, we should be able to maintain the asset quality and try and improve from where it is today. So far as the disbursement growth is concerned, as I said, while we had a muted disbursement in this quarter, given the festival season and the demand that we are seeing, the next two quarters could show some marginal growth, but last year third and fourth quarter were big quarters, given the election fever and the overall conditions being positive and therefore to maintain a growth over that in itself will be a commendable position as compared to the overall sentiments of the market as we see. But net-net, I would think that we would take a position of neutral rather than an aggressive growth posture, but surely not a negative posture when it comes to asset quality, collections and overall maintenance of the margin. Even on the margin front, we would like to state that I think we have come off from the increasing borrowing cost trends, and we do see trends inching towards reducing costs. While we may not get all benefits of reducing cost right up front, as our liability gets corrected we would start seeing the benefit of that, but there is no pressure to pass it on to the consumer and our product mix approach with pre-owned vehicle being one of our growth engine. We would be willing to look at margin maintenance and not a dip from here is what we would like to look at. So I think, overall, I would think the business would kind of remain little neutral to a very marginal growth story and not a negative one. So far as the asset quality we definitely would want to believe there would be an improvement to where we are at this stage. So far as the borrowing cost and maintenance of margin is concerned, I think we would be the beneficiary of reducing cost for sure and we also as a team are focusing on how do we curtail the overall overheads given the situation and you would have seen some trends of that between first and second quarter and we would continue to remain focused on bringing down the cost and bringing in efficiency of operations. Just one additional factor on our cost front would be, there are certain costs which have been debited to P&L, which is more futuristic in nature. For example, we have set up an IT, changed the platform, which is costing us some money, but that is a part of our cost at this stage. Similarly our approach towards digital and analytics where we built a separate team, where one could start seeing the benefit of all this cost over a period of time while they are being incurred at this stage.

So I would think overall from where we were and how the market is, I think we seem to be slightly better off than where we were and looking forward to maintaining that stance and as I said the AUM growth will stay between 15% and 20% as we set out at the beginning of the year. We are being the beneficiary of multiproduct, we have signed up with all the new product launches including with MG Motors as well as with Kia and everyone else and therefore we would be the gateway to rural for this product and we could get benefit of volumes coming from this product and from our prime product like Mahindra auto, tractor, Maruti, etc. I think the volumes will be at the back of what their volumes are, but gaining market share is what we believe could happen to us to be able to get some better off from that. The competition in terms of overall competition, landscape is not aggressive. We do not see them very aggressive and therefore that is the additional benefit that could come our way in case the competition does not participate as aggressively as we saw them a couple of years back.

So I think overall, this is the kind of summary and as far as the subsidiaries are concerned, rural housing also had a similar degrowth in terms of they moving to the new tax regime and therefore they also need to recast their deferred tax liability and to that extent between PBT and PAT, their degrowth rates are a little different, but the continuing problem with rural housing is the state of Maharashtra and one does expect that after this season, that is once the farm cash flow starts coming in we would start seeing improvement to their quality as well and consciously the decision was to go slow on disbursement until the asset quality was put back to trail and we believe with the changing scenario they will also start disbursing and show some growth in this market, but Maharashtra is one state up there, where there was a problem in the last couple of years, which we seem to be fixing up.

As far as the insurance broking business is concerned, again we have made some investments looking at the digital onslaught in that business and therefore the profit may look muted, but clearly insurance is a growing penetration there and they would register growth subject to this additional investments that we have made or additional expenditure we have made looking into future, minus that they would also would have had a growth story of about 20% odd. So as far as asset management company is concerned, it is kind of the industry is not doing too well and at the back of how the industry behavior is I think our growth has also been slightly a muted growth, but I think that is a long-term initiative of ours, and we are not overly concerned about what really happens on a short-term basis. We are adequately capitalized. So we do not need to really look at additional capital allocation to them. So far as our one subsidiary, one business in the US is concerned, the Mahindra Finance USA, is continuing to maintain its growth story. I think we have a $1 billion kind of a balance sheet. We have a 62% penetration and they also are having a profit growth of about 30% odd in that market. So overall I think the subsidiaries continue to contribute, but we would see better contribution from these companies going forward and as the financial services sector our stance is neutral to positive at this stage as we speak to you. So with that, I think, I have kind of finished my summary, and we can open it up for Q&A.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the Anitha Rangan from HSBC Asset Management. Please go ahead.

Anitha Rangan: I wanted to understand what is the impact from the recent development on the securitization bit, is it going to be increasingly difficult to securitize going forward can you give some color on that?

Dinesh Prajapati: So as far as securitization is concerned, frankly speaking, currently the market is more positive for buying the portfolio from the NBFCs, which are into asset class, which are qualified as a priority sector for the bank point of view. So we have seen a quite a bit attraction from the private banks and the foreign banks for buying this portfolio. In fact there was central government's move to give collateral in the form of guarantee, which has also enabled some of the public sector banks to go out and buy the portfolio from companies which are not able to sell the portfolio. As far as we are concerned, we are able to sell our portfolio to the private banks and the foreign banks easily because most of our asset qualifies as the priority sectors. In fact, in this quarter, we have sold almost Rs.2,500 Crores worth of portfolio through the securitization route.

Anitha Rangan: Sir, just one question, after this DHFL episode, has the cost actually gone up or something like, can I understand that they will still like to take the PSL portfolio but does that have any impact on the cost, simply because you have to make the structure more tighter or something like that?

Dinesh Prajapati: No. In fact, as I said, since our asset qualifies as the priority sector and from the market participant point of view or the bank point of view, these are retail portfolio, which has a much safer and a better market, and that leads to the pricing benefit. It is other way around. We are able to get almost 150 basis point discounted rate over the normal borrowing cost or market borrowing cost when we sell down this portfolio. So effectively, it in fact benefits our borrowing cost. Secondly, even recently, last RBI policy, if you see there was on-lending by the bank to the NBFC, which against the agri portfolio or against the SRTO SME portfolio up to Rs.10 lakh and Rs.20 lakh, qualifies as a priority sector for the bank. So we have seen good, attractive deals or the banks willing to participate for this kind of on-lending purpose also with us.

Anitha Rangan: Okay and also I have one question on Mahindra Rural, which is your subsidiary. The asset quality there is like significantly remained very elevated, can you give some color on that because your asset quality and Rural's asset quality is like very, very different and can you give us some color on how that can pan out going forward?

Ramesh Iyer: So like in the beginning also I have said and even in the previous calls, we have had discussions on this, which is one state of Maharashtra where while it may look demonetization is a little old story, but I think the effect of that has caused a larger impact into the cooperative system in Maharashtra and many of these consumers whom we lend to had dependence on the consumer and the credit societies for their own day-to-day operations including borrowing for seeds and fertilizers and things like that and that got held up and they had to use their own surplus for their regular agriculture and that has delayed the installment and it is difficult for these consumers once they are into that overdue situation, to clear all the past dues. So if you kind of look at the movement in the NPL account they continue to pay the current installment or a part of the current installment, but are not able to discharge or come back from the past liability. So it will have to kind of over a gradual period that it will slow down, and we have started seeing a reduction in that and after this season, that is once the crop price is out between November to February, we would see major correction that is happening to this portfolio. As otherwise, if these are secured lending with the land document in our custody, consumers are available to be met to be discussed so they are not arising out of wrong lending or they are not arising out of chasing growth. They are arising out of the cash flow pressures that these consumers went through in the marketplace and our expectation is that we are already seeing declining trend, and we would see correction pre-March.

Anitha Rangan: Okay. Alright. Thank you very much. That is helpful. Thank you.

Moderator: Thank you. Next question is from the line of Prem Raheja, an Individual Investor. Please go ahead.

Prem Raheja: Sir thank you for the opportunity. I was just looking at your employee number from last year to this year, from 20,000 employees you have gone to about 22,000 employees.

Ramesh Iyer: That is right.

Prem Raheja: But our employee benefit expense has gone up 30% on a 10% increase of employees can you just explain that bit, Sir?

Ramesh Iyer: Yes. I think one is you should compare when it comes to employee, March over December rather other than last September over September because we have added employee for based on the last year's needs and growth and last year from an overall performance perspective there were a lot of employee incentives and things like that, that were already given to employees, but if you were to compare it from, let us say, the first quarter to this quarter, or from March to this quarter, we would not have added any employee and even the employee cost would have remained muted. So we have a lot of variability in terms of variable pays to employees, which is based on performances which get paid up and yes clearly 2,000 employees also, add to the cost on a year-to-year basis.

Prem Raheja: Okay Sir, so is there any plan to expand this in terms of our business also to expand?

Ramesh Iyer: So most of the employees that we add normally get added to the collection front and not to the business front because what happens is collection is a cumulative contract number whereas business could be for the year, right so that does not need more employees to be added, but as the cumulative contract keeps increasing especially in a difficult scenario as today where we need to meet the customer more than once, more than twice to be able to pick up installment, the effort levels become higher and therefore in order to ensure that we do not miss out on customers we do add people, but some of them will be in the nature of even temporary or contracting in nature and not necessarily permanent all time.

Prem Raheja: Alright Sir. Thank you very much.

Moderator: Thank you. Next question is from the line of Karthik C from Vista Fund Management. Please go ahead.

Karthik C: Yes. Thank you very much for the opportunity. Two questions from my side Sir. First is on the pre-owned segment, which you alluded to at the beginning. On an apple-to-apple basis, what would be the increase in yields that you are getting relative to, say, a new vehicle?

Ramesh Iyer: In the pre-owned vehicle, tractor or overall, you are asking?

Karthik C: I am just asking let us say on an apple, let us say a pre-owned car versus a new car.

Ramesh Iyer: At least about 4% will be better. It will be 4% higher than a new car. Let us say, if we were to finance a Maruti car we would lend it at about 12% or so or maybe 13% whereas this would be around 15%, 16%. So you will have clearly a 3% to 4% higher yields compared to new vehicles.

Karthik C: And in terms of incremental, let us say, credit costs relative to new, although the pre-owned segment is still a new segment for you guys, what will the incremental credit cost be and in terms of incremental opex is it the same infrastructure and employees who will also be doing pre-owned?

Ramesh Iyer: So clearly, credit costs should be lower than new vehicles because here the vehicle is assessed by us and the valuation is done by us and accordingly margin asked for and lent. So therefore, the resale price and the protection of the asset to the loan given is much higher and the customer interest, therefore, to service will always be better off and most of these vehicles are put to commercial use in rural and therefore a low-priced vehicle almost earning the same returns, is in a better position to service the loan. So technically, one will always find that pre-owned vehicle from a credit cost perspective, if assessed correctly, will always be lower credit cost, right. So far as the opex is concerned, it is no different because what is the opex cost for this is basically traveling and collection costs. It does not matter whether it is a new or an old vehicle. The cost per employee will be the same, except that the value of old vehicle being much lower, as a percentage it may look different if you were to put it across. Let us say if you had to lend Rs.100 on a car and Rs.100 on a pre-owned vehicle and the cost of operations will almost be the same, but as a percentage therefore it may look different because a pre-owned vehicle by value are lower than the new vehicle.

Karthik C: So if I were to just do a back of the envelope, I mean, at 4% higher yield and with credit costs also being lower, so with effect your ROA being let us say about 4.5%, 5% on a post-tax basis if it is at least 3% higher as the AUM share of pre-owned moves more towards your disbursement rate, which is, let us say, somewhere around 18% to 20% can we say it can actually make a marked difference on your overall ROA?

Ramesh Iyer: Yes, it will. It will, but let us be clear that pre-owned vehicle cannot replace a large new vehicle balance sheet. So it will always be in the vicinity of 15%, we were 7%, 8%. Now we are 15% may go up to maybe go up to 20% over a period of time or 15% over a period of time, but if we expect that because the returns are very good and the margins are high, etc., and can it, therefore, replace all the new vehicles, that is not the game around. Because you have got to be in the new vehicle to be also be a good participant in the pre-owned vehicle, at least in the rural market. Otherwise, pre-owned vehicle is not an institutionalized market there, where you can expect to get all pre-owned vehicles from certain intermediaries. So if you participate in a new vehicle, when your customer sells his old vehicle to another customer, is the time that you participate and therefore, currently it is 8%, 9% of the assets and it can go up to maybe 15% over a period of time and to that extent the margin improvement can be seen.

Karthik C: Okay. Perfect. Got it. Sir, my second question is essentially on our funding. Now the offshore borrowing is one segment, which we are starting to tap into quite aggressively. I mean last quarter, it was about Rs.1,400 Crores, now it is at about Rs.2,000 Crores on an incremental basis, the Rs.600-odd Crores which you have raised in the second quarter, what would be the tenure and what would be the all-in costs of those instruments and how does that compare with your domestic rate of borrowing, whether banks or through NCDs?

Dinesh Prajapati: So incrementally, so far, we have raised all our offshore borrowing in the form of ECB loans and as per the RBI regulatory norm, no loan can be borrowed less than three years. So all our ECB borrowing has been three years or around three years. The cost of incremental borrowing in the form of ECB loan on a fully hedged basis including withholding tax currently is around 8.2%, 8.3% on an annualized basis. So if you ask me, compared to the bank borrowing, it is almost equivalent to the presently what we are raising in the banking system. As compared to the bond market, it may look at this point of time slightly costlier because of withholding tax. Going forward we believe that as we establish our relationship in the offshore marketplace we will see some benefit flowing in even the offshore marketplace.

Karthik C: Got it and when we say fully hedged, is it like a one-year hedged on a rolling basis?

Dinesh Prajapati: Fully.

Karthik C: Fully.

Dinesh Prajapati: All the three years. We have not taken that option of rollover, rolling hedge.

Karthik C: Okay. Perfect. Thank you very much and wish you all the best.

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

Nidhesh **Jain:** Thanks for the opportunity. Sir, firstly, on Mahindra Rural Housing Finance, can you share the GNPA ex of Maharashtra and what percentage of AUM coming outside of Maharashtra?

Ramesh Iyer: Can you come back into the question, we can take the next.

Nidhesh **Jain:** Sure and also the collection efficiency data for first half this year versus first half last year on Mahindra Finance?

Ramesh Iyer: Collection efficiency, both years are same at 95%. As far as the rural housing data, just if you can kind of be in the queue and come back, we will give you the detail.

Nidhesh **Jain:** Sure. That is it from my side Sir. Thank you.

Moderator: Thank you very much. Next question is from the line of Kunal Shah from Edelweiss Broking Limited. Please go ahead.

Kunal Shah: So on collection efficiency, again, so has it improved last quarter it was 92% odd in Q1 and you are saying like 95% is for the first half so is there a significant improvement in the collection efficiency, how should we look at it?

Ramesh Iyer: Yes, we would not call it significant, but you will have the seasonal benefit because if there are contracts maturing, I mean the contracts due during this quarter, etc., etc. So clearly yes, there is an improvement over the first quarter and that has been history. First, second, third, fourth, each quarter, you will see an improvement over the previous.

Kunal Shah: Yes, but this is still somewhat equivalent to what it was there in Q2 of FY2019 as well?

Ramesh Iyer: That is right.

Kunal Shah: Okay and in terms of write-offs, so given the credit cost is still slightly on the higher side. So write-off seems to be much higher, which is leading to this kind of gross Stage 3, so the trend of write-off is it higher compared to the previous years or it is still in line with what we have seen in Q2 every year?

Ramesh Iyer: I think if I remember the figure, right, Rs.168 Crores on disposal losses was there last year, and that is exactly the same number even this year. So I do not think it is substantially higher than before. This has been the trend overall all the time.

Dinesh Prajapati: See, last year was the first year of migration to Ind-AS in a full year basis and we had taken a bad debt write-off policy deviation usually we used to do every September and March. We have done in the Q3 last year write-off. So on a current year basis, if you ask me, there was no September write-off event in the last year, whereas it was taken in December.

Kunal Shah: Okay, but otherwise maybe excluding the write-offs, if I were to look at it in terms of the number of NPL contracts, which are there. So how the trend would have been so I think maybe, sequentially, we are still seeing a downside, but that would be some of the accounts would have been written off. So maybe 1,27,000 maybe contracts which are there. How would this have moved ex of the write-off?

Ramesh Iyer: No. So if you look at last year September, it was 1,46,000 accounts or something like that.

Dinesh Prajapati: So on account of write-off, which is around Rs.383 Crores figure there was around 10,000 customers under that back end.

Kunal Shah: Okay. 10,000 contracts?

Dinesh Prajapati: Yes.

Kunal Shah: Okay. And this provisioning, which is there of Rs.40 Crores, which you highlighted, so is it getting factored into this Stage 3 and the provisioning for that number?

Dinesh Prajapati: It is factored in Stage 1 and 2.

Kunal Shah: Okay. So when we are looking at this 1.7%, in fact, that takes into account.

Dinesh Prajapati: Yes.

Ramesh Iyer: Yes.

Kunal Shah: So last time, it was 1.6%, and I think this time, it is 1.7%, so that is where it is considering.

Ramesh Iyer: Yes.

Kunal Shah: Okay and any change in the assumptions for say the probability of default in the current circumstances?

Ramesh Iyer: We expect that commercial vehicle will have a stretch, but there is no major assumption change in terms of resetting the percentages because the model is the same.

Dinesh Prajapati: That undergoes every six months that reworking happens, which June and December. So for all our working for the purpose of PD, this calculation happens every June and December. So this Rs.40 Crores, what we have said is also on account of that PD.

Ramesh Iyer: And which you have taken a little advanced action rather than waiting for December.

Dinesh Prajapati: Correct.

Kunal Shah: Okay.

Moderator: Sorry to interrupt you, Mr. Shah. I will request you to come back in the question queue for a followup question. The next question is from the line of Rushikesh from MoneyWorks Financial Advisors. Please go ahead.

Rushikesh: Hello. Thanks for the opportunity Sir. Sir, my question is that most of the rural-facing companies are facing issues and we have also seen the extended monsoon this year in few states of India. So what do you expect after the festival season what would be the momentum in your earnings would you please put some light on it?

Ramesh Iyer: So the way we look at it, I think even though the monsoon has been a little extended, I think the crops have not been substantially impacted. So we do see the yields to be at least average and the support price announced are also in line with what was previously there. So the farm cash flow, to some extent, should hold up. Yes, will all money come in November, December, or it will go between November to February we believe it may go between November to February given the state government's cash flow positions and things like that. So farm should hold up, but if you look at the overall sentiments of rural, unless the infra story also opens up, whether it is mining, whether it is coal, whether it is road projects once again, I think the contracting segment will have a little stretch, and that is already visible from the commercial vehicle segment. So we would kind of take this into two parts. From a farm cash flow perspective, sentiments should turn positive, but from an infra cash flow, I think it will remain subdued.

Rushikesh: So you do not see any kind of a stress in the farm segment, despite of the extended rainfall?

Ramesh Iyer: I would not think so. I would not think so the stress because once this crop, and then the next crop definitely is expected to be good given the kind of rainfall impact from all the reports that we are reading, and that is a view that we hear also from many people who are very rural focusing, whether it is a fertilizer company, tractor company, anyone you talk to. So I think we should expect that the farm cash flow should not bring in any kind of a stress.

Rushikesh: Alright. Thank you so much for the opportunity.

Dinesh Prajapati: Before you go, I will just take up that question of Investec, wherein the MRHFL gross NPA for Maharashtra region is 18% and for other region is 8%.

Moderator: Thank you very much. The next question is from the line of Kashyap Jhaveri from Emkay Global Financial Service. Please go ahead.

Kashyap Jhaveri: I have two questions. One, on our gross NPL per contract that number, if I look at last, about two years has moved up from almost about 300,000 to roughly about 350,000 to almost about 4 lakh plus on a contract basis if I look at let us say September 2017, 2018 and 2019?

Ramesh Iyer: I think it is product mix change. When you do commercial vehicle and if they come into NPA by price they are five times more than any other product. So therefore the average would look a little different. So I think it is always sometimes good to look at the total gross NPA rather than per contract gross NPA because then they may not reflect the right number.

Kashyap Jhaveri: Sure and second question is on your Tier-1 capital, if I look at quarter-on-quarter that has gone up from about 14.9% to 15.2%. Even if I were to let us say adjust the proposed dividend from June quarter, Net Worth, also 30 bps increase in Tier-1, where quarter-on-quarter there has been growth in AUM, what has contributed to that increase?

Ramesh Iyer: He is just pulling out the number. We will just tell you.

Kashyap Jhaveri: And last question, again, on this same Tier-1 plus let us say NPL, our provision coverage versus historical because of Ind-AS has fallen now to almost about 20% odd, but if I look at your net NPA to net worth ratio, that is about 40% at the end of this quarter, if I sort of were to look at and Tier-1 ratio adjusted for that, Tier-1 ratio would be significantly lower, so any plans of raising capital anytime soon?

Ramesh Iyer: Given the kind of market environment for business, right, I think plus the second half you will always see our collections are much better and that would correct the ratio that you have talked of to some extent, right so the two taken together, I think we will not be in a hurry to raise capital at this stage.

Kashyap Jhaveri: Sure. Thank you very much Sir.

Dinesh Prajapati: So your point of Tier-1 going up is mainly on account of profit addition and the book growth was muted. So logically that leads to increase in the Tier-1 and proposed dividend was already factored in the March itself.

Kashyap Jhaveri: So let us say, Rs.250 Crores profit for the quarter, which is about 2% addition to the net worth and similar we had about 2%, 2.5% Q-on-Q growth in terms of AUM also. So I am just wondering, is there any other reason for?

Dinesh Prajapati: No other reason, in fact.

Kashyap Jhaveri: Okay. Sure. Thank you very much Sir.

Moderator: Thank you very much. The next question is from the line of Jignesh Shial from Emkay Global Financial Service. Please go ahead.

Jignesh Shial: Hi Sir. Thanks for the opportunity. So if I see it correct, I mean, disbursement has been declining by approximately 10% sort of Y-o-Y whereas we are still seeing a healthy momentum on the AUM side. So the first assumption could be that the tenure had been rising for us or overall repayment would have been reducing. So any light on this, that what basically is bringing us 20% sort of AUM growth for now and for full year if we are expecting 15% sort of AUM growth then we are expecting disbursement to remain further weak for the second half?

Ramesh Iyer: No. So one is the number of account maturing versus new account getting added, the new account getting added is definitely higher than the account maturing and when you talked on the tenure, I think it is again, caused by product mix change when you get into commercial vehicle, they are not two-year, three-year product. They are four-year, five-year product. So therefore there will be this kind of a growth that one would clearly see and we do not therefore see any deterioration arising and I think because it is not caused by collection being weaker as you see even our gross NPAs have come down. The number of account in the NPAs have almost remained flat and the next two quarters for rural is invariably a better cash flow and therefore one can only expect some improvement.

Jignesh Shial: Understood and just second and last question. Right now, we see the AUM mix is still more or less similar in last 8 quarters or so whereby tractors remaining 17% across and auto 26%, do you see this disproportion overall, not only in tractors and auto, this mix would be changing in the next four quarters or six quarters, on the back of that agri is doing better compared to infra activities at least for next three or four quarters?

Ramesh Iyer: Yes. So last one or two years, we would have seen the commercial vehicle segment growth for us from 3%, 4% going up to 7%, 8% kind of a situation. I think that would come off slowly because that industry is not doing well and our own expectation is at least for a year, unless the overall economic activity and the infra activity picks up we do not expect that to happen and that could possibly be to some extent offset in terms of the percentage through a pre-owned vehicle segment. So pre-owned currently is 9% and we believe that, that can gradually move towards a 15% kind of a thing in the next couple of years.

Jignesh Shial: So this pre-owned would be what, three-year tenure?

Ramesh Iyer: It is 24 to 30 months kind of a thing.

Jignesh Shial: And the new CV would be three to five years?

Dinesh Prajapati: CV will be four to five years.

Jignesh Shial: See if that gets replaced basically, your tenure is reducing. So that should impact your AUM considering the disbursement remains similar?

Ramesh Iyer: Yes, but the volume will be much higher, right?

Jignesh Shial: The overall volume?

Ramesh Iyer: Yes, overall volume will be higher.

Jignesh Shial: Okay and lastly how is the trend in the Maruti sales right now how you are seeing that and what is the expectation for?

Ramesh Iyer: The question is to understand Maruti or understand us?

Jignesh Shial: No. So for our share in Maruti.

Ramesh Iyer: So our market share has slightly gone up because again it is not because we are doing more vehicle and whatever, whatever. I think it is just that the competition is not as aggressive in that market, so we get benefit of volumes arising out of that. Otherwise, Maruti volumes have remained a little muted.

Jignesh Shial: Okay. Perfect. Thanks a lot Sir.

Moderator: Thank you very much. Next question is from the line of Darpen Shah from HDFC Securities. Please go ahead.

Darpen Shah: Yes Sir. Thanks for the opportunity. My first question is a couple of financiers, CV financiers have mentioned that there is a visible stress across geographies both in new and used segments, so what provides us the comfort that second half will be better for us?

Ramesh Iyer: No. So our pre-owned is not in heavy commercial vehicle. We are a pre-owned financier for car.

Darpen Shah: Sorry. What I was trying to say is in both the segments, used, new, both, the financiers are looking at stress.

Ramesh Iyer: In commercial vehicle or overall you are saying?

Darpen Shah: Everything. Overall.

Ramesh Iyer: No. So I think, see, one has to be very clear about are you a fleet operator financier, are you a large contractor financier or are you an individual consumer financier. So when you are financing individual's personal cars also put to some kind of a commercial use in rural and this format, we have explained in the past, which is we are a very earn-and-pay segment kind of a company and therefore the basic use of the vehicle decides the ability of somebody to pay. So we are not financing a large fleet operator who is waiting for some large projects to be announced, etc., but definitely we get impacted with our subcontractors not able to recover their dues from the main contractor. So to that extent, there is a delay, but that is a small percentage of our overall portfolio. As otherwise, the advantage of being a multi product and multi geographies is that like tractor is definitely not as impacted by those activities or a UV is more people carrier, so it is less impacted or a car is less impacted because again it is used for tourism and people carry. So I think it is the application and therefore the portfolio mix makes all the difference.

Darpen Shah: Sir, if you can highlight how are the movements in early buckets in your portfolio?

Ramesh Iyer: No. So as I said, we have seen a little increase in our Stage 2, which means people from Stage 1 have missed one installment and that is largely caused by September installment being missed and that again is caused by, in many of the major markets, the extended monsoon made it difficult for us to go and collect or for them to come and pay. We do expect some correction of this will happen in this quarter, but as otherwise it is not alarming and significant to worry. As otherwise what would have happened is Stage 3 would have substantially moved if that was the forward trend.

Darpen Shah: Okay. Great. Thanks a lot.

Moderator: Thank you very much. Next question is from the line of Bhaskar Basu from Jefferies Group. Please go ahead.

Bhaskar N. Basu: Yes. Thanks. I actually missed your initial comments, but I caught that you mentioned that you are talking about a 14% to 15% AUM growth for this year. Your loan growth has been decelerating and given that disbursals are down almost like 10%, what makes you confident of a 14% growth and are you kind of expecting a positive disbursal growth in the second half and if so which segments would drive that growth?

Ramesh Iyer: So as I said, pre-owned vehicle is something that we are focusing on and pre-owned in terms of utility vehicle, car, tractors, etc., and we do believe that, that will help us maintain some growth. We are gaining market share. Clearly, when it comes to UV and tractors and cars in the rural market so that is the other reason why we believe that there can be some growth for sure and three is the number of account maturing are definitely lower than the number of accounts getting added to the portfolio and these three together is what makes us confident to believe that we can maintain a kind of a growth, but as far as 10% degrowth that you talked of, I think apart from market there are also two other reasons. One is the extended monsoon has caused a little less footfall at the dealerships and things like that and second is invariably we have seen when the festival season is in the first week of October and end of October, there is a postponement that naturally happens from September to October because people do expect better deals to be made available at the marketplace during the festival season. So to that extent the postponement of September would be a benefit, which one can get in October, but I want to stay clear to say that what we see as a change number for October, November is not a fundamental correction to the changing market sentiment.

Bhaskar N. Basu: Because even last quarter, barring the UV segment and the pre-owned segment, which obviously is only about 18% of your book, most of the other segments have seen a decline in disbursals?

Ramesh Iyer: No. Commercial vehicles is degrowing 60% in the market, right so therefore that is not something that we are talking of a growth for us, which is why we are seeing pre-owned vehicle. Now we would not have done enough of pre-owned vehicle in the first two quarters, which was backed by tractors and cars and UV. Having got into that segment, we will see growth coming from that in the following quarters.

Bhaskar N. Basu: But that is only about 18% of your AUM.

Ramesh Iyer: That has to grow.

Bhaskar N. Basu: And that will offset some of the declines you are seeing in segments like tractor, PVs and all?

Ramesh Iyer: Not completely, but we should not mistake that no growth does not mean no disbursement, right? Commercial vehicle may not register a growth, but it may still disburse the same value and if the number of accounts maturing are less than the disbursement that we make, there will be an increase in the asset.

Bhaskar N. Basu: And just your initial sense on the festive demand so far you would have seen.

Ramesh Iyer: So Dussehra was above average and the dealer sentiments at least, the sound that we hear is that Diwali/ Dhanteras is expected to be a big bumper.

Bhaskar N. Basu: Okay and on the margins, I mean, my last question here, margin seems to have shrunk. I mean either sequentially as well as on a Y-o-Y basis. What is driving this, given that you are supposed to get some funding cost tailwinds, yields appear to be kind of flattish on a calculated basis, so what is really driving the margin correction and how do you see that?

Ramesh Iyer: So I am not sure sequentially, it would not have dipped too much, but it is flattish, but definitely, year-on-year, it has dipped because of the product mix change. So when you do commercial vehicles, they always come at a much lower rate as compared to another products so once we get into pre-owned vehicles, you would see a reversing trend in the margins as well and importantly, we said this even last year, if the borrowing cost, to some extent, we have absorbed given the market condition because we had to play a partnership role rather than playing an individualistic role and therefore when there is so much pressure on the selling side that is our contribution to the market, that even at the cost of taking a little pressure on our margins, we have absorbed the borrowing cost, but the same, again, would be applicable as we start borrowing at a much better price, not necessary that we have to pass it on immediately to the marketplace.

Bhaskar N. Basu: Okay and any guidance on the credit cost for the year?

Ramesh Iyer: So the only guidance is historically we have seen the third and fourth quarter to be better than first and second quarter and if we are able to maintain our asset quality at this level in the first two quarters our expectation and belief is that we should do better.

Bhaskar N. Basu: Okay. Thanks a lot.

Moderator: Thank you. The next question is from the line of Adarsh from Nomura. Please go ahead.

Adarsh K: Sir, question on cost, right. One has been asked about our cost growth has been high in the last few quarters, but even historically, we have not been able to kind of get economies of scale over like five, seven years and when you look at a downturn period, what you end up seeing is cost to AUMs tend to go up as well and this is one part, as you mentioned, some of it could be linked to collections, right You have to put more effort to go and collect the same money, but even apart from that, historically, you have periods of high growth and low growth and our cost to AUMs have actually not been able to, we have not been able to bring that down, so if you can comment both on a short-term basis, the high Y-o-Y growth and over a long run why we have not been able to derive economies of scale and cost?

Ramesh Iyer: I think one has to be very clear that the last three or four years has been a very unstable four years from the marketplace, right some months are good, some months are weak, but you cannot resource people and any other resource just on the basis that some months will be good and other months you will not have people. So we have had situations of carrying some additional cost as a burden. Benefit of it has come whenever we have done well. I mean if you were to go to last March and just take one March, the efficiency would have been as best as ever possible from all angle. No, that cannot be considered to be the benchmark for the next 11 months or 12 months of the year. So to some extent I would think we are a little lower productive given the market condition there is no secrecy about that and second is we are also a variable cost company when it comes to people and therefore what happens is when your performance is good you need to pay them off on those incentives, which have been agreed, and it pushes up that cost to some extent. Apart from this, if you look at what are our other costs it is largely traveling and conveyance and look at the fuel price that has moved over a period of time and even with the same number of people traveling the same distance for the same time, will always be costlier than before, and that is the cost that we have to incur. And last, I would think, is also some of the costs that we have incurred is to be a little more future-ready, like we have incurred a cost on when we are changing our IT platform, we have engaged with TCS, and that is also coming into our operating costs, and that is not being separated out from this cost. We have also invested adequately in digital and readiness for future as well as in the analytics part of it. Now the benefits of some of these would come a little later. So I think overall, market sentiments or the market conditions being a little more volatile will always not allow stability in terms of productivity is concerned. Two is, as I said, futuristic cost incurred and debited to P&L already and clearly three is all the related cost is going up and which is going to come and sit in our book for sure. So if you kind of look at from all three, that is the reason you do not see the kicker benefit of the scale and unless all branches start doing all products which will happen only when the market conditions improve.

Adarsh P: So that is the short-term reason for costs to go up, more on a more like five, seven-year basis also we have not seen and then you have had periods of decent growth?

Ramesh Iyer: This is a variable model. See, if the fixed cost is only at zone and achieve, rest are all variable model. It will move with volumes. If collections are high, cost will be parallelly high, if the business is high it will be high, but you have incurred that cost on people and sometimes when the market does not do well you will have to still incur the cost and it would not give you the benefit. This model is made that way. I have always said, the lowest one could expect as a cost in this business is 2.85% to the asset and the highest one could see is 3.15%. In the worst market conditions it will go up to 3.3%, 3.4%. So for us, you must factor 2.8% to 3%, 3.1% is the range in which we will be on the cost side.

Adarsh P: No, I am just trying to, because you have a very large part of profitability.

Ramesh Iyer You may need to engage into a meeting because I think the Q&A we cannot be handling all of this. So why do not you fix up a time with Dinesh, we can take you through the structure, and you will have a sure better understanding of how this whole thing is.

Adarsh P: Perfect and Sir last question on cost, right? So the last three, four months since May and June, the regulator has supported liquidity, so rates have gone down. So how much will be the benefit that you should get on funding cost now over the next two, three quarters?

Ramesh Iyer Before Dinesh answers the funding question, since you touched on regulatory, if you look at the regulatory costs in the last couple of years from various angle, even that has pushed the cost up. So thank you for reminding that part.

Dinesh Prajapati: As far as funding cost is concerned, incrementally, almost all the borrowing instruments have seen a reduction in the cost. So it varies from the banking channel, the cost of incremental funds have come down by 30 to 40 basis points if I see on a year lag basis. Similarly, if you see the incremental bond borrowing costs have come down by 50 basis points. However, the transaction at the bond market level has been quite shallow. The market participants in the bond market is quite limited, given that the mutual fund industry is unable to get the inflow and their inability to participate in the bond market. So even though the bond market has seen the sharpest correction, it is still not able to give the desired quantum in the marketplace. Other source of borrowing, as I was explaining because of the securitization demand on the PSL as well as the on-lending guidelines which the regulator has changed has helped the company like us, which has the PSL asset, to get a better deal from the banking system for borrowing at a better terms. Even the shorter-tenor flow of money, which is the CP market, the rates have corrected by almost more than 200 basis points over the year, but one thing has happened is post these liquidity squeeze, which happened last year, from then onwards, most of the companies including our company has brought down the short-term borrowings so as a mix of the overall borrowing. So earlier, we used to carry almost 12% of our borrowing mix from the shorter-tenor bucket, which is presently around 4% to 5%. So to that extent, there is a replacement of liability from the duration paper, which is also negating the effect of the reduction in the borrowing cost.

Adarsh P: Perfect. Thanks a lot Dinesh Sir.

Moderator: Thank you very much. The next question is from the line of Shweta Daptardar from Prabhudas Lilladher. Please go ahead. As there is no response we will move onto the next participant. The next question is from the line of Mayur Parkeria from Wealth Managers India Private Limited. Please go ahead.

Mayur Parkeria: Sir, actually, it is again, a little bit on the cost side, the collection structure. I just wanted to understand in brief, if you can explain the collection structure, we have an entire team and that team is variable and keeps on increasing as the AUM increases. Is there any other model which is present especially for the rural market or are we looking at any other structure or this is going to continue as we go ahead?

Ramesh Iyer: So one is broadly the structure is, we have a business team, which also handles the first 12 months of collection and they have been given a bunch of people who will help them with that collection. So that is one set of teams. The other set of team is by bucket, zero to one bucket, two and three bucket, etc., different buckets and there is a legal recovery team, which is collecting from hard buckets, from the bad debts and disposal recovery, etc., and then there is a team which looks at the disposal of repossessed vehicle as a portfolio. So this is the overall structure. Now this will definitely increase as a team, as we go more deeper and as we add more and more contracts because we need to have cumulative contract is what we need to recover from and therefore there will always be need for more people. Now till such times, rural continues to repay in cash, and the cash flows are not very standard and structured, which means they depend on different seasons and therefore, you may have to visit consumers sometime more than once, twice, thrice to even able to pick up. So to that extent, the physical model will continue. Now the alternatives could be that can we introduce digital means of repayment, etc., which we have already initiated, but not a very large percentage of consumers still come through that platform. The third format that is possible is to engage with some external agency, who can help us recover, but that is something that we have not found favor to and we would not possibly get into because at the end of the day, he is collecting cash and he is answerable for the remittance and one could have a major weakness arising out of misappropriation, etc., and that is something that...

Mayur Parkeria: Sir, but any noncore activity within the collection spend, which can be outsourced and we can get benefit of?

Ramesh Iyer: It is mainly one that crosses your mind, noncore.

Mayur Parkeria: No, I mean, maybe the procedural work, the paperwork

Ramesh Iyer: Collection has only one job, go to the customer, ask for money. After collecting the money, give the receipt, bring the money and remit it in the branch or in the bank. It is absolutely nothing else they do and whatever are the answers they get from nonpaying customer, they transmit it back into the system or a business team, if they have to take any action or the legal team if they have to take any action. And they are not kind of people who are aspiring in terms of growing into career becoming managers of future, etc., there will be a very small percentage of them who will be trained, coached, guided to become business and from business to become branch head, etc., etc. Otherwise, they are kind of feet-on-street kind of a people, which is the hardcore travel, go-to-the-customer, effort job.

Mayur Parkeria: Sir, on an annualized basis, if you see the cost to average assets today is approximately 3.3% today, as on this quarter and you mentioned that these are the ratios, these are the numbers which one should normally see in a scenario, which is an extreme case. If we look at the NPA side of this story for us, I think it is an improving situation compared to where we were 12 months back?

Ramesh Iyer: NPA is 1,25,000 contracts out of 3 million live contracts.

Mayur Parkeria: Yes. Sir, what I was trying to say is, that is not the signal of the...

Ramesh Iyer: The effort is on the 3 million contract.

Mayur Parkeria: No, but what I am trying to say from an economic situation, while the situation on growth outlook is not good, but the NPA and the collection is not at its worst situation where we were 12 months before?

Ramesh Iyer: That is why the cost on effort, no. It will look what...

Mayur Parkeria: Yes. So but then still costs are 3.3% of assets, sir, should not it be more in the region of 2.85% or 3%?

Ramesh Iyer: It will be when the customer cash flows improve for the same effort you will get double the money. Today, we are getting maybe less than double the money. Please do not forget that to collect one installment we are visiting three times today and therefore the efficiency is maintained. When the customer cash flow improves, in one visit we can collect which means the overall collection will be even much higher than this. Like you look at last March, our collection efficiency was 114% and if you were to look at cost at that stage of employee to collection it will be less than 2%. So there will be months where the collection efficiencies go as low as 90%, or maybe a little low and there are months where it goes to as high as 114%. Unfortunately, in this model, you cannot have differential cost that in low months we will have less people and in high months we will have more people. So therefore it averages out like this.

Mayur Parkeria: Sir, Maharashtra has been big for us always across. With election and in the past, once or twice we have been during...

Ramesh Iyer: Maharashtra has not been big for us. For Mahindra Finance, Maharashtra has not been as big. It is UP which is bigger, Bihar, which is bigger. MP, which is bigger. Maharashtra maybe sixth or seventh.

Mayur Parkeria: Okay. Sir, but this election issue, no negative surprise we can expect in Q3 as far as collection or entries?

Ramesh Iyer: It is just two days of election and it is all over.

Mayur Parkeria: Okay. Yes. So no major...

Ramesh Iyer: There are no surprises. That is the change of results, which brings new set of people then how the state is going to be, anybody's guess, but as far as election, action and activity is concerned, it is over. No surprises.

Mayur Parkeria: Okay. Thank you Sir and wish you all the best.

Moderator: Thank you very much. The next question is from the line of Dhaval Gada from DSP Mutual Fund. Please go ahead.

Dhaval Gada: Just a couple of questions. First is a data-keeping one. Could you just repeat the write-offs number for the second quarter and reconfirm the number for second quarter of last year?

Ramesh Iyer: Second quarter of last year, write-off was 0.

Dinesh Prajapati: The current quarter write-off was Rs.384 Crores.

Dhaval Gada: Okay and the first half number is roughly Rs.474 Crores.

Dinesh Prajapati: Yes.

Dhaval Gada: Right. And the same number last year was Rs.141 Crores. Is that correct?

Dinesh Prajapati: Last year, there was no write-off in the first...

Ramesh Iyer: Rs.169 Crores was disposal of both years.

Dinesh Prajapati: But there is a termination loss...

Ramesh Iyer: Rs.168 Crores.

Dinesh Prajapati: Which is, if you see first half of last year was Rs.210 Crores, this year it is around Rs.200 Crores.

Ramesh Iyer: So it is almost same.

Dinesh Prajapati: Less.

Ramesh Iyer: Rs.10 Crores less.

Dhaval Gada: Understood and that Rs.200 Crores is part of the Rs.474 Crores?

Dinesh Prajapati: Part of the Rs.980 Crores, total charge to P&L.

Dhaval Gada: Understood. Okay. And the second question, Sir, was just on portfolio quality, you started the conversation by saying that customer is choosing to de-lever rather than consume, but the collection efficiency number if you look at it from a first half to first half basis it is still unchanged and so just wanted to understand, why do you get that feel and the second part is, last year, fourth quarter, we saw a sort of write-back of provisioning. Just a related question on credit cost is, the coverage that we have since the time we started disclosing under Ind-AS from 2018, the coverage, including Stage 1 and 2 is the lowest at this point of time. So I just wanted to understand portfolio quality expectation and then what do you see the outlook on credit costs especially for the last quarter?

Ramesh Iyer: Yes. So quickly, on the coverage, if you kind of look at the write-offs, that is the reason why the coverage has gone down by at least 5% or 6%. So one needs to look at that as something as an action taken by us and therefore, otherwise 19 now would have looked 25 therefore 43 would have looked like a 48 or a 50, but as far as the reason why we felt people are wanting to pay off and not buy assets, it is not just related to our customer who is repaying. General sentiment of the market is we know that people have some cash flow, and they are not adding assets. If any, they do with the money is that they are trying to discharge the liability was the comment. It is not restricted to our customers. Our customer who is repaying may not necessarily be an asset buying customer at this stage, but from an overall market if you look at in the rural market, if our customers have the money there is a general belief that there is money in the market with most of these customers out there. One would have expected if there is so much money to buy more assets, which they are resisting to buy at this stage.

Dhaval Gada: Understood and Sir, just on that fourth quarter write-back, do you think that phenomena can continue for this year or that is unlikely?

Ramesh Iyer: At least historically, we have seen that last quarter, we get a write back, unless something very substantially goes wrong in the marketplace, which we do not expect at this stage.

Dhaval Gada: Perfect. Thank you so much. All the best.

Moderator: Thank you very much. Ladies and gentlemen due to time constraint that was the last question for today.

Dinesh Prajapati: So before you close, I just wanted to clarify one of the queries of Tier-1 capital, why there is an increase? There is one more element to it, which is the deferred tax write down has happened because of the tax rate change. So to that extent, deferred tax adjustment is also there and which is why the Tier-1 capital increase is there.

Moderator: Thank you Sir. Thank you very much. On behalf of IDFC Securities Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.