

Analyst Meeting Transcript July 23, 2014

Moderator: Thank you. Good evening and welcome to L&T Finance Holdings Limited's Q1FY15 earnings conference call. We have with us on the call today Mr. N. Sivaraman – President & Whole-time Director and other members of the senior management team. We will initiate the call with opening remarks by Mr. Sivaraman followed by an interactive Q&A session.

Kindly note that some of the statements made in today's call may be forward looking in nature and a note to that effect is stated in the presentation sent to you earlier. I would now like to request Mr. Sivaraman to provide his views on the results during the quarter ended June 2014 and on the strategy going forward. Thanks.

N. Sivaraman: Good evening all of you. Thanks for joining us this evening. I will cover the first three to four slides which talk about the results at the holding company level on consolidated basis. We have Mr. Dinanath Dubhashi – Head of the Retail Finance Business, Mr. G. Krishnamurthy – Head of Wholesale Finance Business and Ms. Ashu Suyash – Head of the Mutual Fund Business. The three of them can take you through the respective business segments and thereafter we will throw the floor open for questions.

Starting with slide 3 which is the economic outlook – The aspect I would like to focus on is that the budget has provided a direction in terms of the new government's intent on various policy decisions going forward which is positive. At the monetary level, the liquidity levels have been comfortable and the interest rate has been stable. We will have to be cautious with respect to emergence of a high inflation situation which would consequently impact both liquidity as well as interest rates. It could also possibly have an impact on consumption growth and therefore create some issues in terms of any new capital investments. But hopefully with the inflation numbers for the last few months having been benign, it seems that we are reaching a situation of stable to declining inflation as of now.

Monsoon is an area of concern, but I think July has been one of the better months. It has rained quite well. The deficit has been reduced from 40 odd percent to around 25 percent on an all-India basis while the dispersal is still a cause for concern. While the government's own fiscal deficit target may look challenging, there are two areas which could perhaps help. One will be the divestment initiatives and the second would be the changes made to the mutual fund taxation laws, which could partially fill the gap in terms of tax buoyancy. Current account deficit has been stable over the last 12 months or so. Hopefully, this will remain stable given that oil prices and gold prices have remained stable.

Moving onto the Key Performance Highlights - the asset growth has been robust at 19% Y-o-Y. The good news is that the asset growth has come in the areas of our preferred choice, which are rural products, personal vehicle finance and housing as well as operating infrastructure projects in the wholesale segment. We continued to be pretty cautious in credit selection. From a new initiatives standpoint, the IDF- NBFC has commenced operations. The first disbursement has been completed in the current quarter. We have a strong pipeline coming through. AMC continued to achieve growth and maintained

its breakeven level, even though there were two NFOs done during this quarter. Stable NIMs, stable operating cost as well as stable credit cost has resulted in the overall profit growth to be in line with the asset growth.

To delve on few numbers - we have had a 19% growth in assets. Disbursement growth had been lower at 11%. As you will see in the later sections, the disbursements in the retail segment have been flat while the wholesale segment had seen some growth based on disbursements to operational assets. NIMs have stayed steady at 5.53% as compared to the 5.61% in the fourth quarter. The credit costs also appear to have stabilized at about Rs 159 Crores as compared to Rs 162 Crores in the previous quarter. It is also not significantly higher compared to that of the previous year's same quarter. We believe that perhaps we are seeing the peak of the NPAs, more so in the context of the restructuring pipeline having slowed down considerably. Except for those which are under consideration there have been no new additions as far as we are concerned on the restructuring book as of today. So all of this has helped in reporting a PAT growth of 16% in the lending segment to about Rs 179 Crores as compared to the previous year's Rs 154 Crores. I would also say that this profit of Rs 179 Crores is after considering the one-time effect of higher depreciation of about Rs 9.5 Crores on a pretax basis consequent to the change in useful life of assets under the new schedule 2 of Companies Act 2013. So if you actually adjusted it for the one-time effect, the profit growth would have been around 19%-20%.

Investment management has achieved a 44% growth in average assets under management. It is happy to note that the equity segment has also shown positive inflows on a net basis. The two NFOs we completed this quarter have also helped along with the market improvement. The PAT before amortization is almost at the breakeven level. I will now hand over to Mr. Dinanath Dubhashi who heads the Retail and Mid-Market segment.

Dinanath Dubhashi: Good evening. I will first go through the market scenario in various segments of retail business and then will talk about what has been our strategic response and hence growth in overall disbursements.

So the headline number of course is that our disbursements in the retail segment have been flat, but we must look at various components of it. Starting with tractors which is our flagship product in the rural segment - you would remember that last year the industry growth in tractors was upwards of 20%. This year, the first quarter has been flat and even the best estimates talk about a 2%-5% sort of growth over the entire year for the industry. But we have grown substantially, upwards of 25% in this sector which is an outcome of the strategy we have followed.

As far as the other segments are concerned, the two-wheeler industry continued to grow at a robust pace, with the scooter segment continuing to see good traction. Here too our tie-up with some of the leading MNC scooter manufacturers has helped us. Car industry continued to not do that well. It is flat and also lots of dealers have been reportedly giving very heavy discounts. We do not see an immediate revival in the car segment going ahead. Bad news continues for the construction equipment and commercial vehicle segments. There have been talks of bottoming out - however, we believe that even if the situation improves on the ground, there is enough stock on the ground with manufacturers, with customers and

with finance companies. This will ensure that the industry will take at least 6 months to pick up.

The Mid-Market segment which is the mid-corporate segment that we lend to, liquidity continues to be strained; however as Mr. Sivaraman mentioned the pace of bad news seems to have slowed down considerably. We do not see new NPAs coming in, of course the old NPAs are still slow in getting resolved but that seems to be the trend overall in the mid-market segment. So considering this to be the industry scenario across different segments, we have to look at what our growth has been, specifically the disbursement growth which is an outcome of our strategic response to the evolving market scenario.

So a big question that you may have in your mind is what is happening in the rural segment given that the monsoon has been deficient at least in the first quarter or in the month of June. So of course there has been news of improvement in monsoon. Still certain areas of the country like Kutch, Rajasthan etc. face a big rainfall deficit. As a result tractor industry growth is flat. It is also possible that the repayment capacity of farmers will get affected. In fact our NPAs increased in the first quarter and it is partly due to this. This is our core segment. We will be careful in disbursements, but what we want to do is to do it intelligently. So what we have done is to go through very strong manufacturer tie-ups. We have tied-up with leading manufacturers in tractors which will help us in both monetary and non-monetary support on the ground. This is the time when manufacturers are ready to help financiers in order to maintain the industry growth and industry sales. We are taking full advantage of that and hence you will see that while the industry growth is flat, our disbursements in rural products have increased by 28%. In scooters, again we have increased market share, but of course in the personal vehicle finance segment, we have grown by only 7% at aggregate level.

Microfinance, the good news continues. Our strategy of having diversified our presence in the states we are in and concentrating on processes and on very strong systems is paying off. Though off a small base, we have grown by 80% in the microfinance segment. We are now entering into new markets and launching new products. Another segment which is growing and in which there is a fairly strong demand is promoter funding in the form of loan against shares which is done with excellent security and tightly tied cash flows.

Construction equipment and commercial vehicles - we are actually willingly giving up market share in an industry which is falling. As a management strategy we will wait for the industry to turn around truly and visibly before taking any aggressive calls on growth in this sector. So that is an overview of the segment wise industry scenario and what our response has been to achieve the growth rates and the corresponding increase or decrease in market share that we have seen. The loans and advances growth in each of the segment reflects what I discussed on the disbursements and the overall book has increased by 11%. We continue with our strategy of growing in B2C segments and reducing or remaining cautious in the B2B segment.

Apart from the strategy related to the product mix the other major highlight for the retail business is with regard to establishing systems, putting in place procedures and bringing about technology orientation in the business. We have continued with our efforts in these areas. A

large part of our disbursements now happens with aid of tablets. The entire receipting happens on hand held mobiles. We believe that it will go a long way in establishing a robust system and also eventually aid in optimizing costs.

Moving to the Summary Financials – Y-o-Y there has been an 11% growth in gross book, the NIMs have grown at 20%. This is the dual effect of maintaining yields on products and treasury optimizing the interest expenses. It is also an effect of gradually shifting the product mix towards B2C. Operating expenses show a 25% growth, but as Mr. Sivaraman said, part of it is due to one-time effect of depreciation. Major focus of the management is of course the 21% growth in credit cost. This is due to two main reasons. The corporate NPAs have more or less steadied. Construction equipment and commercial vehicle NPAs have definitely gone up from March, but that was largely expected. There is a seasonal increase in GNPA which we have seen in tractors. Normally tractor GNPA's do increase in June. But payments start coming in the month of June as a good part of the monsoon arrives in June. This year up to the last day of June, there was hardly any monsoon and hence the seasonal increase in NPA was a little more than what we see every year. We are in control of the situation and have taken steps to bring it down in the following quarters.

Moving to the Ratios slide - it reflects what we have just explained. Net interest margins have improved Y-o-Y from 6.17% last year to 6.59% now. Even over sequential quarters, the net interest margins have improved largely in line with the guidance we had given last time, in fact a little more. Operating expenses have been stable as I have mentioned. Credit cost is at 1.9% which is perhaps a little more than what is typical for the business mix that we have. The seasonal effect of delay in monsoon on the farm portfolio in addition to existing stress in CE and CV portfolio has caused this. That largely covers the retail portfolio.

Coming to the housing finance section, most of the key metrics are in line with our strategy of growing the business. We have seen good growth in housing finance. The book now is more than Rs. 2,000 Crores supported by decent disbursements and the overall performance is as per plan. I now hand over to Mr. Krishnamurthy for taking you through the Wholesale Finance section.

G. Krishnamurthy:

Thank you Dinanath and good evening everybody. We will run through the market scenario and outlook for infrastructure sector first. There were a lot of announcements in the budget with greater focus on policies for infra sector. If we take an overall look sector by sector, for thermal it has been largely positive. The Union Budget talks about a directional intent to ensure coal availability for all projects which are to be commissioned till March 2015. There are also discussions on setting up a proposed equity fund and an ARC which will essentially take over private sector projects which are stalled and ensure that they reach completion. There has also been an extension of tax exemption under 80-IA till March 2017 which gives complete clarity to developers. So all these are good measures and positive measures, but we also see that there is no significant announcement on reforms in the distribution segment. This is one area where we would expect more private sector participation as a solution for the issues in the sector. In renewable energy, there has been a very strong focus particularly on solar with announcements on UMPP. In addition to the announcements, we do generally expect a larger focus on solar as a sustainable renewable source of energy for the country. Given that

we have a good franchise in solar segment and have established a good market position, we do expect to benefit from this in future.

In roads, there have been announcements for 8,500 km of construction target which would be substantially through EPC. The positive impact would be that this will increase the order book position for EPC contractors. This will result in quicker turnaround of some of these construction contractors whose balance sheets are currently over leveraged. Also, there have been significant initiatives in changing the model construction agreement and putting in place a dispute resolution committee to ensure faster redressal of claims on cost escalations.

At an overall sector level, there are two things which are going to significantly impact the way business is done in the infra sector. One is the flexible structuring which has been allowed, the so called 5/25 scheme. What it ensures is that we are able to structure loans for projects with a 25-year duration with the actual loan being for only a period of 5 years with bullet structures and refinancing - this will not be considered as a restructuring anymore. So one would be able to finance the infra projects with 7-year money. We expect greater pools of investor money to be available for the infra sector for financing itself. Any short-term problems for 6 months or a year should not affect the repayment capacity of these projects, given the flexibility and structuring which is now allowed. It will improve the ALM position of banks also. It will ensure that tariffs are not front-ended because loans are finally repaid over a 25-year period instead of a 10-year period. So there are multiple positive benefits for the sector.

There has also been an announcement on banks being allowed to raise long-term bonds for infra sector without having to account them for calculation of SLR/CRR and PSL targets. Our view is that it is likely to deepen the debt markets and enable us to diversify our liability sources. Today, we take liabilities from the banking system - essentially about 50%-60% of our liability book is from banks and then we lend in competition with the banking system where we are part of a consortium. So once the bond markets improve as a result of this particular measure, it will enable us to access the bond market on the liability side and will therefore make us more competitive on the asset side.

Moving on to the next slide on disbursements - as usual disbursements are very lumpy in our business and therefore quarter-to-quarter changes cannot be taken as a trend. This lumpiness is more accentuated now as we are doing refinancing of existing operational projects. The business model we follow here is that we take out the entire existing banking system out of the project and we disburse the money and subsequently we sell down parts of it. Typically we hold may be 30%-40% of the loan and we sell down the balance over the next quarter or two. So this will lead to some degree of lumpiness in the disbursements. Having said that, one interesting feature is that in Q1 65% of our disbursements were towards operational assets substantially in roads and renewable sector. This is being partly facilitated by our IDF. Our IDF-NBFC is now operational. They made the first disbursement in Q1 and we expect greater traction for our business on the operational road projects as we move forward.

If you look at the portfolio breakup in terms of corporate and projects, there has been a substantial shift in the portfolio breakup. One year

ago, we had under construction projects at 30% which has come down to 27% now, but the bigger shift is in operating projects which has increased from 28% to 42%. So there has been a substantial shift in the portfolio. This is happening on account of two things. One is that our incremental disbursements are substantially towards re-financing. Other is that historically from 2011 to 2013, we have disbursed a fair amount of money in the renewable segment and these projects have a very quick cycle where they get commissioned in a year or lesser. Therefore they are shifting from under construction to operation much faster. So the cycle of movement of projects is getting faster because of the type of disbursements we have been doing. So at overall book level, we still have renewable power at 19%, it is a predominant portfolio segment and 15% in thermal power. Even within thermal power; it is almost a 50-50 mix between under construction and operational assets. So the core portfolio in terms of under construction thermal projects is much lower compared to what other market competitors have in their books.

Moving to the next slide on the Summary Financials - gross loans and advances has increased by 19% on a Y-o-Y basis and on a quarter-on-quarter basis it has increased by about Rs. 500 Crores or so. Borrowings have increased by 23% essentially meaning that over one year we have leveraged more. Our debt-to-equity has gone up compared to one year back. While the asset book has grown by 19%, the interest income has grown by only 14% on a Y-o-Y basis to Rs. 545 Crores. This is essentially due to two trends - one is the increasing amount of NPAs and restructured assets where no interest income is booked. So this has resulted in a lower yield at the overall book level. Additionally since we are financing more of operational projects which are fairly low risk, the yields are also slightly lower. So to that extent, progressively there will be a slight tapering in the yields. This is already reflected in our interest income being at 14% growth vis-à-vis a 19% growth in the loan book. Interest expenses have grown slightly lower than the amount of borrowings reflecting an improvement in our overall cost structure. As a consequence NIM has moved only by 3% over the last one year.

Fee income in first quarter has been Rs. 6 Crores. This has been a bit muted, but fee income is also fairly lumpy. In Q4 of the last year we had a substantially higher fee income. For Q2 of the current year, we have built up a pipeline of projects for underwriting and we expect better fee income in Q2.

Moving to credit cost - Credit costs at Rs. 53 Crores are stable compared to Q1 of last year and have improved compared to Q4 of last year. The nature of credit cost itself is changing to the extent that we have made additional provisions towards existing NPA assets to improve the provision coverage. We do see some level of mitigation in the levels of stress in the book, but whether there is a trend is something which we need to wait for a quarter or two more before we draw any conclusions. Gross NPAs - there have been three assets where there have been slippages but two of those assets are essentially undergoing CDR and we do expect them to revert on completion of restructuring in the normal course. As on June 30, the provision over RBI norms stands at Rs. 105 Crores.

The next slide in on the key ratios - Yield in Q1 has been 12.23% vis-à-vis 12.71% last year which as I have explained earlier. The cost of funds has come down marginally from 9.40% to 9.32%, so net interest margin has come down to 4.2%. We do expect our net

interest margin to marginally come down over the next few quarters, but would be more or less at these levels going ahead. Fee income for the current quarter has been muted. We expect a better performance over the next couple of quarters as our underwriting pipeline increases. Credit costs as we discussed are lower at 1.2% vis-à-vis last year as also vis-à-vis last quarter and gearing is at 5.2. We do see a large ability to increase this particularly because our CRAR is very comfortable at 17.99%, out of which 16.09% is at tier I level. So to that extent, we will be able to support larger asset additions over the next few quarters. I will now hand over to Ms. Ashu Suyash to take you through the investment management business.

Ashu Suyash:

Thanks G.K. Good evening everyone. I will take you through investment management business starting with slide 18 which is the outlook and strategy. Industry average assets have grown by 9%, growing to Rs. 9, 87,000 Crores from Rs. 9, 00,000 Crores. This has come on the back of positive equity sales and this positive trend is almost after 7 or 8 quarters. It has also been helped by positive markets and also money market assets coming back since there were large outflows during the previous quarter. However, one of the key issues is that the budget had quite a few negative points as far as the asset management industry goes specifically with respect to non-equity oriented funds which covers fixed income as well as hybrid and fund-of-fund products. It was negative because the holding period went up from 12 months to 36 months. There was an increase in dividend distribution tax as well as capital gains. There have been several representations and depending on the final outcome which we will know in the next couple of days, you could see a significant change in the composition of fixed income funds.

From our perspective, our focus for the coming quarter is to continuously grow the equity book on the back of a better investor sentiment and positive markets. We will be launching a new fund, L&T Business Cycle Fund. Depending on the outcome of the budget, we are in the process of repositioning our fixed income range and looking at attracting longer term money and encouraging investors to stay invested for 3 years in the fixed income fund range as well. Our focus on investor education continues and the focus will be around staying invested in equities with a long-term view and ensuring that fixed income continues to be a strategic allocation in the overall portfolio.

Finally, control on operating expenses and discretionary spends continue to be very high and we maintain a sharp eye on spends. Key risk in this market-linked business is about any significant market correction either on account of external headwinds or where expectations are short versus what investors generally think.

Moving on and covering how the business has done – we have grown in line with the industry. We are ranked 14 on an average AUM basis and have grown by 9%. The growth has come on the back of two equity NFOs, the L&T Emerging Businesses Fund which garnered Rs. 230 Crores during the NFO time and the Arbitrage Opportunities Fund which raised Rs. 120 Crores. In addition, we now see positive net sales across most of our funds.

Coming to the P&L – our overall growth on a year-on-year basis as far as assets go is about 44%. Revenues are up 26% compared to Q1 last year. When compared to Q4, operating revenues are marginally down that is in line with our payouts as and when we raise

equity assets. Operating expenses are under control and on a profit after tax but before amortization we track close to breakeven. You do see that the net yield on the overall portfolio has come down as compared to last year. This is only a reflection of the fact that growth right through last year was on account of fixed income which tends to be a lower yielding asset class on an overall basis. In the coming quarter, our focus will be equities and we hope to continue to gain share in that category.

I will now move to Wealth Management – Our wealth management business is a nascent business, but has grown quite well. As you know, we serve two main client segments, the high net worth customer through our private wealth offering and the mass affluent segment through our premier wealth offering. We have a fund selection unit with a set of dedicated research professionals, staffed by senior bankers and we offer a comprehensive range of products and services that not only covers mutual funds, but also real estate and fixed income. We have a team of 53 advisors and do business from 9 major cities in India. We have seen good growth in our overall assets under advice. For the first quarter, our average assets under service was Rs. 6,139 Crores, a good increase from the previous quarter and we are doubling from similar quarter last year. Client base has grown extremely well with over 2,000 clients from just about 850 clients a year ago. Our strategy will be to continuously focus on the domestic market to customize investment solutions and in addition look at NRI customers in UAE and Muscat. We have recently started our operations in Dubai and have obtained a representative license there and you will see this adding to our business in the coming quarters. With that, I now hand back to Mr. Sivaraman.

- N. Sivaraman:** We can have questions if any, happy to answer all of them.
- Moderator:** Thank you very much sir. Participants, we will now begin with the question and answer session. We have the first question from the line of Parag Jariwala from Macquarie Capital. Please go ahead.
- Parag Jariwala:** Our preference shares outstanding are around Rs 1,200 Crores. What is the average interest or dividend rate paid on this?
- N. Sivaraman:** Average should work out around 9% roughly.
- Parag Jariwala:** This is even subject to dividend distribution tax, right?
- N. Sivaraman:** This will be subject to dividend distribution tax, but to the extent dividends are up streamed from the subsidiaries, it is fully offset. So there is no additional commitment of this distribution tax.
- Parag Jariwala:** Okay. So even if it is around Rs. 80 odd Crores for dividend including dividend distribution tax it works out to nearly 15%-16% of the profits. What is the rationale for doing this? Even if I assume 10% dividend distribution tax, the 9% works out to close to 10% and we do not get any tax benefit on this. I have not seen such kind of structure with other NBFCs. Is this not creating negative value for the equity shareholders?
- N. Sivaraman:** I think you should look at our statutory advertisement which talks about the EPS moving from Rs. 0.75 for the quarter ended June 30, 2013 to about Rs 0.85 this quarter. Both are excluding the exceptional items and are not annualized. It tells you that there is an

EPS growth of around 13%. Preference shares are a way of achieving leverage across the group, which is increasing the leverage to more than what we would have done if we are only an operating entity. To achieve this we have to build leverage at the holding company level. If we borrow debt, it is subject to section 14A disallowance under the income tax act. So even if we borrow at 10% or 9.5%, there is no tax offset available on that. So what we are doing is that we are borrowing, rather than raising preference capital at the holding company level, putting it as equity or Tier-1 which works at the operating entity level. So we are aiming to earn equity returns on the borrowings that we have and then we upstream the dividends from the subsidiaries to the holding company. The entire dividend is offset against the dividend tax payable at the holding company. So it is definitely far more efficient than raising equity for the simple reason we are raising the equity at the operating entity level which comes in at a cheaper cost than what we would have done otherwise.

Parag Jariwala: That is right. Sir on the asset quality, do we have any pipeline for restructuring, especially for infra? What is the outlook?

N. Sivaraman: Yes, you would have noticed from the newspaper reports that the restructuring pipeline has shrunk quite substantially against the Rs. 40,000 Crores pipeline in the fourth quarter. We are talking about Rs. 12,000 Crores in the first quarter of the current year. So systemically, the overall restructuring proposals are coming down. As far as we are concerned as Mr. Krishnamurthy mentioned, there are two proposals under CDR at the moment which means that they have already been referred for restructuring and the banks are considering them. Other than that, we have nothing in the pipeline as of today.

Parag Jariwala: So can you quantify that?

N. Sivaraman: Which one?

Parag Jariwala: These two projects, what should be our total exposure?

G. Krishnamurthy: These two CDR cases are currently slippages which are shown as additions to GNPA and in case of restructuring they will revert to standard assets.

Parag Jariwala: So our stressed asset will not change?

G. Krishnamurthy: Yes. That is correct.

Moderator: Thank you. Our next question is from the line of Rahul Jain from Goldman Sachs. Please go ahead.

Rahul Jain: Actually I have got couple of questions. First is on retail and mid-market, so the increase in gross NPA that we saw during this quarter versus the previous quarter of about Rs. 74 odd Crores. Is this primarily because of rural financing?

N. Sivaraman: It is contributed by rural finance to some extent and from the CV and CE book as well.

Rahul Jain: How much would that be from rural?

- N. Sivaraman:** I think we have given it at an overall retail book level. We consider most of the slippages as seasonal. It should roll back in the next two quarters.
- Rahul Jain:** And of this rural finance book that we have got, how much would be tractor finance or is this all tractor finance?
- N. Sivaraman:** About 85% will be tractors.
- Rahul Jain:** Second question is on the cost side - if you see, our operating expenses actually have increased versus the last quarter. The margin is about 4 basis points, but significantly versus the last year by about almost 30 basis points or whereabouts. I remember when we met you, you talked about taking lot of initiatives on the technological front, but yet the numbers have not really come down. So what is your thought process on the trajectory going forward?
- N. Sivaraman:** First is if you look at the last four quarters ending the first quarter this year, it has been pretty steady at about 2.7% except in one quarter when it went up to 2.9% on account of certain costs we incurred in putting new initiatives together. These have already been rolled out. These take some time to really be reflected in the cost structure. The roll out of some of the technology initiatives has reached about 75% and it will take another quarter or so when it will be fully done. Even if you look at the current quarter 2.76% there is a set of one-time effect as I mentioned to you. One is the depreciation effect of about Rs. 7 Crores in the retail book and also there were some reversal for provisions in the first quarter of last year which is not reflected. If you really look at it on that basis, effectively the operating cost will be more like 2.65% which actually shows some level of reduction. As we put the full synergy into play in the next two quarters, our assessment is that we should drop down by about 15 basis points by the end of this fiscal year. In the fourth quarter I look at this kind of improvement getting fully reflected.
- Rahul Jain:** Sorry what was this reversal about in the last year?
- N. Sivaraman:** There were some cost provisions which were there for the previous fiscal year. When the actual disbursements happened, we reversed that. That would have contributed to about another 3-5 basis points.
- Rahul Jain:** Another one was on your housing finance book. There again the gross NPAs jumped up significantly versus March 2014.
- N. Sivaraman:** There are two components to this. One is the component with reference to the portfolio that we purchased from Citigroup. These are slightly volatile portfolio segments while there are slippages on that account. We have also acquired good amount of the NPAs which we have already written-off when we bought the book. I think this will be a continuing trend for some time till the book fully stabilizes. So the Citigroup portfolio does not give us any net credit cost charge to the P&L account. The second is there are around a handful of accounts where there are some issues which are under recovery at the moment using the SARFAESI Act. This should get sorted out in the next 2 quarters. If you really eliminate them, the normal portfolio is not showing any deterioration.
- Rahul Jain:** Why I am asking you this question is that even if I were to take your March numbers which was 1.2%, our NPAs would still be on the higher side as compared to others.

- N. Sivaraman:** Agreed, as I mentioned to you this is all arising largely from the book we brought from Citibank. They have been volatile right through. I think we are getting our hands around it. It will take about 2 or 3 quarters to stabilize. But as I mentioned to you, the net credit cost charge to the P&L account may be negligible because we are also recovering from the written-off book simultaneously.
- Rahul Jain:** Okay, alright. Another thing was on your ideal mix of home loans and LAP, what do you think would be perhaps 12-15 months down the line, where would you want to see this mix?
- N. Sivaraman:** The combination of home loan and residential project financing should be in the region of about 65% to 70%. So the financing of construction project will help us both get yield as well as origination at the same time. You must note that we are in the early part of growth. So we want to make sure that we have earned enough from the portfolio to make the investment for both product expansion and network expansion. So we would like to look at some of the higher yielding book to begin with which is why you will have LAP being good part of the book as well as the construction funding.
- Rahul Jain:** What would be the yields on the LAP portfolio that you would be earning?
- N. Sivaraman:** Around 12.5%-13.5%.
- Rahul Jain:** Quickly another question was on wholesale business. In your remarks Mr. Krishnamurthy, you said that you are acquiring some of the loans from banks and I see transportation book nicely moving up. But what kind of spreads would you be earning? Typically I would imagine you would want to perhaps fund more new projects, of course you know there is dearth of it. But the profitability would not be really great on the refinanced kind of projects. So why would you want to go there in the first place? So can you just help me understand that?
- G. Krishnamurthy:** Two things which we need to understand. One is these are PPP assets which have 50% risk weightage. So to that extent, my capital allocation is much lower. In fact you will see that in the actual numbers where there is a divergence between debt to equity and CRAR. While debt to equity increased so has the CRAR. So when I do my pricing and costing, obviously I can afford finer yields because there is lesser capital which I need to put on the table for these assets. That is the prime driver. The secondary driver is also that when we do these deals we are also doing some of this in fixed rate structures and long-term bond structures, part of which we are doing with the IDF and balance which we are selling down over a period of time. So we do expect a kicker as and when we sell these assets. So while the initial deal may be lower at an overall level, with the completion of these transactions we will still get our desired returns.
- Rahul Jain:** So of this Rs. 1,800 odd Crores of total book that you have got, how much would be refinanced projects?
- G. Krishnamurthy:** Well, I do not have a number off the cuff, but what we can say is that 42% of the total outstanding is operating which includes two streams-refinanced assets and assets which we have financed in the last three years which have shifted from under construction to operating.

- N. Sivaraman:** To give you the current quarter's disbursements, roughly about 60%-65% are operational projects which amount to refinancing of those projects and you can take that as an indicator.
- Rahul Jain:** Just a final question about any thoughts on the small banks and payment banks guidelines that RBI has put out?
- N. Sivaraman:** Difficult to respond at this point of time because we have not worked out the business case and viability of this particular form of existence. So at the moment, we are neutral. We would like to study it more and make sure that we understand it better. If it is going to be an entry point, maybe we can consider it at a broader strategy level. But if the universal bank license will anyway be available in the next few quarters, we would like to look at that in a more interested manner.
- Rahul Jain:** Did you get the response from RBI as to what was the reason behind not considering your application in this round?
- N. Sivaraman:** There was a letter, but it did not indicate any specific reason for the rejections. It was a general motherhood statement.
- Moderator:** Thank you. Our next question is from the line of Nischint Chawathe from Kotak. Please go ahead.
- Nischint Chawathe:** Just trying to kind of dwell a little bit more on the operational assets. Would it be fair to say that the yield on the operational assets which you would have disbursed during the year could be somewhere in the range of around 12%–12.25%?
- G. Krishnamurthy:** Yes, I would like to say it is lower than our current average book yield and definitely to the extent that the assets are AAA, it could be even much lower than that. So the range of rating that we have been doing is A to AAA. So there is a fair degree of linkage to what is the credit rating and therefore rates do differ.
- Nischint Chawathe:** You also mentioned that you would have some component of fees or increasing yield structures where your overall yield could be higher than what you are able to see today. Is this understanding right?
- N. Sivaraman:** Nischint, as GK mentioned, there are three aspects that we need to consider. One is that it has a higher credit quality, consequently the potential risk on credit cost around these kind of projects is low. They are already rated A+ and above. These are the kind of projects that we have looked at. The second important piece is that the benefit of putting together an IDF and a pure project infrastructure finance proposal on the ground. As you will be aware, the IDF is a tax exempted entity. So even if say that one third of this is still from the IDF, to that extent the spreads are completely tax exempt. The third piece is that these are large ticket items. Consequently the operating cost will have to be amortized over a longer period of time. Last but not the least as GK mentioned, it allows the leverage which is far beyond a normal project assets because the risk weightage is only 50%. Effectively if I have to maintain an AA+ rating, I can live assuming that 100% of the book was made up of operational assets. I can easily do around 8-9x leverage without much of a rating related concern. That is the perspective you need to understand. While you may see a dilution in ROE in the year in which you are booking the asset, as you keep this asset on the balance sheet over a period of time, it will play out extremely well on the ROE side.

Nischint Chawathe: Subsequently over a period of time, you would kind of push in around one-third of the assets to IDF?

N. Sivaraman: We have already done that. One case, we have already booked about Rs. 60 Crores of assets on the IDF. We are awaiting more approvals from NHA. Once that happens, we will see it getting booked and I expect by the end of the year, at least about 10% of the total balance sheet to be sitting in IDF.

Nischint Chawathe: Okay, currently it would be how much?

N. Sivaraman: It is about Rs. 60 Crores.

Moderator: Thank you. Our next question is from the line of Mayur Parkaria from Wealth Managers. Please go ahead.

Mayur Parkaria: Have you set any target for ROA and ROE over the medium term?

N. Sivaraman: Yes, from the lending operations, we would like to target around 18% ROE in the medium term. If you look at the current year's performance, the pre-credit cost ROA is about 4% on an annualized basis. It is about Rs. 400 Crores of pre-credit cost profit and with a Rs. 40,000 Crores of asset. It indicates about 4% on a pre-tax basis. We do expect the overall NPA levels to stabilize and start reducing in the next three quarters. Consequently, the credit cost will also keep tapering down as we progress towards the end of the fiscal year. I would say that by the fourth quarter we should be at 1% or slightly lower levels of overall credit cost for the entire lending operations. That will enable us to produce an ROA on a post-tax basis from the region of about 2.2-2.3%. That would give us our current year fourth quarter ROE based on a 6:1 gearing level. It should be a healthy ROE to begin with which sets the platform for the next few years.

At the consolidated level, I would say that while the AMC business may not contribute significantly in the current year, but I think with the accretion of equity assets and the size that we have been able to acquire, we will have a good platform for contribution from this business over the next two years or so. So at the consolidated level, we can start seeing some improvement.

At the earnings level, part of the capital requirement is being met by preference shares. In addition to that, the proceeds from the sale of City Union Bank shares also will provide us that additional ability to meet the capital requirements of the downstream entities. So on an EPS level; I think we can start seeing improvement coming through. Somebody asked a question about without the exceptional items what has been the growth in the context of the preference shares that we have raised. As against June 2013 we had an EPS of Rs. 0.75 without annualizing, in June 2014 we had an EPS of Rs. 0.84 excluding exceptional items which means about 12% improvement in the EPS, that reflects what we are earning for the equity shareholders. So I expect that this would continue and we would see stable-to-improving margins, stable-to-reducing operating costs and credit costs are expected to taper down over a period of time – all of which would contribute to the EPS of the shareholders.

Mayur Parkaria: Sir you mentioned pre-credit cost ROA of 4%, am I right?

N. Sivaraman: That is correct.

- Mayur Parkaria:** But if I look at, I am not able to understand this and the credit cost is at around 1.8% or if we take on an overall basis average of around 1.6% and the actual ROA of around 1.5%, so how do we tally?
- N. Sivaraman:** I was giving you an indication of how it will pan out by the fourth quarter. I am not talking about the current quarter.
- Mayur Parkaria:** So we will touch this level in the fourth quarter?
- N. Sivaraman:** That is correct. Additionally margins may also improve further with any changes in the interest rate environment and operating cost too would improve. So the 4% can also improve slightly.
- Mayur Parkaria:** Sir if I look at the levers on the ROA again, I am trying to just go from the top down approach. The gearing on the wholesale side had some room to improve, which is for the ROE. But from the ROA perspective if you look at the major indicators, the wholesale NIMs are relatively much lesser to what we have in other comparable NBFCs. So that is one aspect, the second is obviously the credit cost.
- N. Sivaraman:** If you look at the operating expenses, it is also substantially lower than the other NBFCs right?
- Mayur Parkaria:** Our wholesale NIMs are in the region of 4.5% and retail is in the 6% regions, which both also put together are much lower. If we see other niche NBFCs with ROA of 3%+, they generate 8% kind of NIMs.
- N. Sivaraman:** First of all I think you talking about Mahindra Finance or a Shriram Transport. They are primarily in the retail segment. They do not have the wholesale segment in their portfolio at all.
- Mayur Parkaria:** Retail-to-retail perspective, I understand the businesses are different. But I am just looking from investor's point of view. Why should I look at a NBFC with such a small ROA? I understand that the business structures are different, but the yields again on our retail book are only 14.5% and the costs are also higher.
- N. Sivaraman:** I think it is not appropriate to discuss in this manner on a call. Please meet us and then we can explain to you. Broadly I am giving you a guidance as to how it will pan out by the fourth quarter and why I am saying that we will be closer to our target ROE by the end of the fourth quarter. That is the explanation I have given you, but if you want more details, we can sit and talk about it please.
- Mayur Parkaria:** Sir one last question on this. You said ROA target of around 2.2% on the overall.
- N. Sivaraman:** I said by the fourth quarter, it should be possible for us to produce an ROA of 2.2% on the lending book.
- Mayur Parkaria:** And ROE of 18% right?
- N. Sivaraman:** The target ROE is 18%. We will move closer to it by the fourth quarter.
- Mayur Parkaria:** So does that mean that gearing will substantially improve to more than 8.

- N. Sivaraman:** It will be driven by operating cost improvement, NIM improvement, as well as credit cost reduction.
- Moderator:** Thank you. We will take the next question which is a follow up one from the line of Nischint Chawathe from Kotak. Please go ahead.
- Nischint Chawathe:** Just going back to the IDF, now you have 49% stake in the IDF if I understand this correctly.
- N. Sivaraman:** As of now, it is 100% owned Nischint.
- Nischint Chawathe:** And you plan to subsequently reduce it?
- N. Sivaraman:** There is a regulatory requirement to reduce it to 51%. The group can own 51%. So we have another about 3-4 months to go. Since you asked this question, when that sale happens it will also release capital to the group.
- Moderator:** Thank you. That was the last question. I now hand the floor back to the management for closing comments.
- N. Sivaraman:** I hope it has been useful interaction for all of you and thank you very much for participating and staying with us for so long. Thank you.
- Moderator:** Thank you. Ladies and gentlemen on behalf of L&T Finance Holdings that concludes this conference call. Thank you for joining us. You may now disconnect your lines.