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Operator: Ladies and gentlemen, good day and welcome to the Mahindra & Mahindra Financial Services Limited earnings conference call. As a reminder, all participant lines will be in listen-only mode, and there will be an opportunity to ask questions after the presentation concludes. Should you need assistance during this conference, please signal the operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded. I would like to inform participants that this call is for analysts only. Any participant joining from the media may disconnect the call now. I now hand the conference over to Ms. Urmi Patel, Head of Investor Relations at Mahindra Finance. Thank you, and over to you, Ms. Patel.

Urmi Patel – Head Investor Relations: Thank you, {? Dorwin ?}. Good evening, everyone. We welcome you all to the Q2 earnings conference call of Mahindra & Mahindra Financial Services Limited. Joining us on the call today from management are Mr. Raul Rebello, Managing Director and CEO; Mr. Pradeep Agarwal, Chief Financial Officer; along with other members of our management team.

We will begin today's session with opening remarks from Mr. Rebello, following which we will open the floor for Q&A. The audio recording of this call will be made available on our website shortly after the call ends. Before we begin, I would like to remind you that certain statements made during the course of this call may be forward-looking statements. Such statements are based on expectations and involve a number of risks and uncertainties that could cause actual results to differ materially from those in such forward-looking statements.

With that, I would now like to hand over the call to our Managing Director and CEO, Mr. Raul Rebello, for his opening remarks. Raul, over to you.

Raul Rebello – MD & CEO: Thank you, Urmi. Good evening, everyone. For those of you joining from other time zones, good morning and good afternoon.

I am very happy to share the quarter's results with you. As usual, I would request you to keep the earnings call document and the quarterly results document handy, as we will be referring to certain pages that will be useful for you to refer to as I present my commentary.

To start with, let me say that the entire management team is very encouraged by the way in which the Q2 results have turned out. I would say that the Q2 results are a reflection of the many quarters preceding this one, the operating diligence on which the team has been focused, and which has resulted in what we call very steady results from a growth, margin, and risk standpoint.

From a growth standpoint, please refer to page 5. You will see that our disbursement growth has grown at a steady pace of 22%. This 22% growth has come clearly from our core business, which is the wheels business, as well as from the growth coming from the diversification agenda that we had highlighted in our SME and mortgage businesses.

Looking at asset quality, GS2 plus GS3 at 8.1 is pretty much at an all-time low in terms of our GS2 plus GS3 numbers. Credit cost has been within the range that we had indicated, between 1.3% and 1.7%. Q2 credit cost is at 1.6%. With strong growth in disbursements, AUM growth of 15%, asset quality being under control, and our other operating metrics, including OPEX, being very stable, we

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have been able to deliver sound PAT growth of 55%, at 882 crores.

Moving to page 6, I did talk about diversification within the franchise. We are very proud of the core wheels business that we have built over many decades, but as an organization, we were very keen to unlock new facets of growth. I am happy to report that the overall lending AUM, which is at 156,000 crores, now has 20% coming from non-wheels and 80% from wheels.

Of course, the 20% non-wheels component includes some amount of the quarterly disbursements, or the book that we build for trade advances, so that is also included in the non-wheels business. Overall, though, in our growth plans, I did mention that we would like to grow between the 16% and 18% range. The core business grew 21%, and the non-wheels business, at 52%, is a healthy sign in that direction.

Along with the wheels business and the non-wheels lending business, we have subsidiaries which, for many years, have not been operating at their full potential. We have been working very closely with the subsidiaries to turn them around. I have been talking over the last 2 quarters about how the subsidiaries have been steadily adding to the overall consolidated numbers. I am happy to note that this quarter is also a step in that direction. MRHFL posted a healthy PAT of 35 crores—

Operator: Ladies and gentlemen, please stay with us. The management line seems to have disconnected, and we will be reconnecting with them.

Operator: Ladies and gentlemen, we thank you for your patience. We have now reconnected with management. Over to you, sir.

Raul Rebello – MD & CEO: Apologies for that glitch. I will go back a few seconds. I was on the page preceding this one. I was discussing holistic growth coming from various asset categories. Before that, I had just made the point, for those of you who may have missed it, that the diversification agenda is progressing well. We have very strong growth in our core business at 21% and in the other lending business at 52%, along with very steady growth from the subsidiaries.

I request you now to turn to page 8. On page 8, you will see that growth is very holistic and secular, coming from all asset categories. We have the wheels business firing on all cylinders: passenger vehicles at 28%, the used business at 15%, CV/CE at 16%, tractors at 13%, three-wheelers at 32%, SME at 13%, and our other businesses at 71%. Therefore, growth at 22% is coming from a very holistic and secular contribution from all categories.

Moving to asset quality on page 9, it is fair to say that we had a lot of seasonality built into our earlier quarterly numbers. You would have seen spikes between quarters in terms of our GS3 and GS2 numbers, as well as credit cost. I think it is fair to say that, with our underwriting, risk guardrails, and collection discipline, we have turned the corner in terms of the volatility in inter-quarter GS2 and GS3 numbers.

For your reference, in the top right-hand corner of the page, you will see that even up until last year, we had a 9-bps increase in GS3 numbers between Q1 and Q2. We actually saw a sequential fall in GS3 of 3 bps. In GS2, which had a 7-bps decrease last year, this year the decrease is as much as 17 bps.

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This is leading to our credit cost also showing a smaller increase. Historically, credit cost saw a spike between Q1 and Q2. Last year, the increase was 23 bps, whereas now it is only a 5-bps increase. Therefore, a great deal of credit goes to the management team across underwriting, risk, and collections. We have really turned the corner in terms of inter-quarter volatility, and our credit cost numbers are now very range-bound, even within the quarter.

From a capital adequacy standpoint, since the underlying assets are nearly fully secured, at 18% capital adequacy with 16.2% Tier 1, we are fairly well capitalized for the next phase of growth.

I mentioned a couple of quarters ago that, with some of the headwinds we were seeing from the West Asia crisis, as well as the El Niño-related drought risks, we thought it prudent to build up our liquidity buffers. Our liquidity buffer has almost doubled from last year in rupee value terms. We have clearly erred on the side of being extra cautious in terms of liquidity buffers.

This does cause a drag on our returns because we set aside this corpus, which does not yield anything and causes a drag. However, in the overall scheme of things, we have taken the view that it is better to be extra conservative, and that is why the liquidity buffer is at these all-time high levels.

Moving to the next page, page 12, we have circled the final ROA. I did mention that our aspiration is to move the franchise to an ROA of 2.2%–2.5%. I would say that, under the DuPont framework, there are various levers available to us, and from 1.6% last year, we have moved to 2.2%. Sequentially, we have fallen, and you should see that the fall is largely in terms of loan income—

Management: As I alluded to, between the 2 quarters, the liquidity buffer creates a denominator effect, which creates a drag. We are also on the cusp of Q1 and Q2, when we create a heightened amount of trade advances. Trade advances are the grease for our festive business, and trade advances are at a very high level right now. They do not yield anything.

These are the 2 factors that are not structural but are more seasonal in nature, and they cause a compression. We do see ourselves returning to the loan income levels from Q2, which in my mind are at the absolute base level.

Moving to the next point, please stay on page 13. I have provided a final consolidated P&L view for H1. Since we are at the end of 2 quarters, as a franchise our ROA is at 2.3% and our PAT has grown 68%.

I will take a couple of minutes more to conclude and then hand the call over for questions and answers. I request you to move to page 18. In our overall operating model, the efficiencies in the BFSI operating model clearly have to incorporate the AI toolkit. I did share with you the plans for incorporating the AI toolkits from an efficiency standpoint.

All our AI investments are directed towards 3 areas: first, revenue increase; second, operations; and third, collections. I am glad to report that, if you look at the sequential improvement from the AI toolkit, it is adding material value to our disbursements, which are now 1,663 crores.

On the operations front, 75% of our back office is now fully covered by AI-enabled operational workflows. On the collections front, our call centers have been substantially supported by 12

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regional AI vernacular bots, which are giving us both rupee-value benefits and a reduction in error rates. Our call centers are also being enabled with AI calling, resulting in better efficiencies.

Finally, moving to page 20, we have consistently highlighted our key priorities for the franchise as we move closer to our F31 overall goals. We remain consistently focused on 5 priorities.

The first is the core business: defending the core business and ensuring that we continue to be a meaningful player by growing market share. We are seeing that progress well. Our market share across various wheels businesses is moving in the right direction.

Our diversification plans in mortgage, SME, leasing, and fee income are growing well. Our progress on margins has been decent. Risk has been very stable, as I mentioned. Overall, we are incorporating a resilient model that includes new-age toolkits to ensure that our OPEX ratios remain under control.

I must also point out that our cost-to-income ratio, which was earlier above 40%, has now declined to below 37%.

This gives us confidence that we are progressing in the right direction. Of course, I need to keep my commentary balanced. We are all aware that certain headwinds have been relevant to the NBFC and BFSI space. The recent one relates to the new consultation paper on insurance.

While it is still early days, it can have a material impact if it is implemented on its own initiative and in its current form. However, we have been making representations, and we also know that other representations are underway, so it is too early to quantify the outcome.

Having recently taken a corporate agency license and also having a broking arm, fee-based income was a significant part of our plan. We had discussed increasing fee-based income from 1% to 1.6%. I am not saying that the entire 60 bps is attributable to insurance. A portion of that 60-bps increase has come from insurance.

We will have to watch and wait to see how the final regulation plays out. Having said that, I believe that as a franchise, we will be able to use the various levers at our disposal to incorporate what needs to be incorporated if and when these regulations come into effect.

We are also carefully watching how the drought-related scenarios in the 3 states and the 282 districts are playing out. Our tractor business is very closely tied to the local economy. We are a very distributed business. As you know, we have 25,000 employees, many of whom are in the collections function. Thankfully, all of them are extremely connected to the micro-markets, and we have a reasonably strong connection with the local micro-markets to influence collections as things develop.

With that, I will pause here and open the call for questions and answers, which Pradeep and I will take.

Operator: Thank you very much. We will now begin the question-and-answer session. Anyone who wishes to ask a question may press star and one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star and two. Participants are requested

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to use handsets while asking a question. Ladies and gentlemen, we will now wait for a moment while the question queue assembles.

Our first question comes from the line of Shreya Shivani with Nomura. Please go ahead.

Shreya Shivani – Nomura: Thank you for the opportunity. I have 2 questions. The first is on the movement in the cost of funds. On slide 12, it is flat for you sequentially in Q2. However, with the rate hike that has come through and the excess liquidity that you are holding, what kind of trajectory should we expect for the full year FY27? Any guidance on that front would be useful, especially given that the majority of your book is fixed-rate and the ability to pass on the increase to the end customer could be restricted to that level.

My second question is on the asset-quality trends that we have seen here. I understand that you are watching the drought-like situation and the drought in the 3 states, but what measures did you take in Q2 itself? Are we continuing to take those measures in Q3, or have we recalibrated those measures in the states where the monsoon was relatively adequate? Any color around that would be useful. Thank you.

Management: Thank you. You had 2 questions: one on cost and the second on asset quality. I will take the cost question first and invite Pradeep as well.

You are right that, among the various headwinds, we recognize that we are in an environment where we have seen one rate hike and have to prepare for possibly more. I believe we are currently at one of the lowest levels. We have a very efficient treasury team, and I must mention that, besides being connected to the rate environment, we also have an additional tool in the form of priority-sector lending.

I must mention here that we are one of the biggest suppliers of priority-sector agricultural lending, considering the amount of loans we have in underlying priority-sector assets, including tractors and CVs. Even today, we are able to offload many of those assets through co-lending, or rather through on-lending, through securitization, and so on.

We do have that advantage, but we recognize that the cost of funds is at a level where we need to remain cognizant. You pointed out that the bulk of our loans are fixed-rate. Yes, the bulk of our loans are fixed-rate.

However, as we have diversified, with 80% of the book in wheels and 20% in non-wheels, transmission for non-wheels is faster because those loans are not fixed-rate. The SME business and our other businesses are completely floating-rate.

Even for the wheels business, we will clearly factor in that the environment has changed. Therefore, at least the incremental assets that we book will come in at a higher rate. In this environment, we have to be responsible, pass on what we can, price in what we can, and offload our priority-sector assets to retain the benefit of the arbitrage that exists and has been available to us.

Pradeep, is there anything else on cost before we move to asset quality?

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Pradeep: We have been disclosing the proportion of our floating-rate book. As you articulated, if a 25-bps increase is implemented on our floating-rate book, this would result in almost 10 bps of the existing stock being repriced within a reset frequency of, you could say, one quarter. That is the nature of the rate hikes.

Also, if you look at the market, it is already factoring in more hikes going forward. Therefore, with a lag, refinancing also comes at a higher cost, in addition to the floating-rate reset of existing borrowings. The increase in the rate cycle will have an impact on the cost of funding going forward.

Shreya Shivani – Nomura: Would you offload some of the excess liquidity if needed, or are you planning to hold it at these levels?

Pradeep: Overall, the liquidity buffer will also depend on the repayment obligations we have on a month-on-month and quarterly basis. There may be some flexibility to reduce this liquidity buffer, but not to a very large extent.

Management: To add to that, the liquidity buffer is a dynamic situation. We watch the environment very closely. If the overall triggers demand that we maintain it, we will do so. Right now, as I said, we are erring on the side of being extra conservative.

However, if we see the clouds thin out, we are clearly sitting on a very high level of liquidity, and that can give us some gains. We do not see the liquidity buffer increasing from here. We do see the possibility of reducing it, depending on the circumstances.

Coming to asset quality, this is also a dynamic situation. As I mentioned, 282 districts have been classified as drought-prone. What we have proactively done is augment collections in these locations. We have our own collection infrastructure, and we also rely on external collection infrastructure when required. We strengthen the organization if we need additional capacity for collections.

That is what we do on a constant basis. We have mentioned in the past that close to 9,000 of our employees are collection officers. We therefore have a good level of penetration in all the markets where we need to be.

Our collection philosophy is fair but firm. We make sure that we are able to collect if the environment is conducive. However, if underlying customers are in a difficult situation, we are accommodative. That is the position we usually take.

Proactively, in Q2 we reduced some of the funding in certain stressed locations. That is what anyone would do: be a little more conservative while keeping the stress in those locations in mind.

Shreya Shivani – Nomura: This is useful. Thank you very much.

Operator: Thank you. Our next question comes from the line of Renish with ICICI. Please go ahead.

Renish – ICICI: Thank you. Congratulations on a good set of numbers. I have 2 points.

First, it is encouraging to see that we are moving towards a structurally tighter and better operational design, with disbursements now moving to AI-led tools. As of Q2, roughly 10% of

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disbursements are already AI-led. I wanted to understand a few things around this.

Over the next 4–6 quarters, what percentage of disbursements do you think will be AI-led? Also, can you share some more data around asset-quality or profitability metrics for AI-led disbursements? I understand that it is too early to establish any trends, but if we are structurally moving towards an AI-led business model, this data will become more important going forward.

Management: Renish, I will qualify what we mean when we say AI-led. It is not that we are doing straight-through loans. A large part of our wheels business now has AI toolkits incorporated into the loan journey.

For example, customer qualification was earlier conducted only through dealer counters. We now also qualify customers in our refinance business who take top-up loans. For businesses that are AI-enabled, I do not want you to think that we no longer sit at the dealership, press 2 buttons, and obtain a car loan.

These are not end-to-end AI processes; they are AI-enabled. That is why we have used the term AI-orchestrated very carefully. We said that this is an AI-orchestrated business. It definitely comes in at a lower cost of acquisition. It does not have the same cost of acquisition; it has a lower cost of acquisition.

You can connect some of these points to our OPEX-to-average-assets ratio and our cost-to-income ratios. We do see some of these metrics improving structurally. However, I want to clarify that this is not 100% digital-only.

Renish – ICICI: Understood. Are there any numbers around the asset-quality data?

Management: What about asset quality? We have published all the numbers. What additional information are you looking for?

Renish – ICICI: I am referring to the 1,600-odd crores, or perhaps the 900-odd crores, that we disbursed last year. If someone wants to look at that customer cohort and understand how those customers are behaving after disbursement through an AI-enabled tool, I wanted to get some sense of that.

Management: Yes.

Management: I would remain cautious, but we are monitoring all of {? 30 plus 60 plus ?} as well as the X bucket and so on. There are no early insights for us to form a differentiated view on this.

Renish – ICICI: Understood. My last point is on growth. Over the last 4 quarters, we have seen a steady acceleration in AUM growth to almost 15% year-on-year. Considering that, as you already mentioned, we are somewhat conservative in certain districts and there is noise around a possible rural slowdown due to El Niño, how do you see growth developing over the next 4–6 quarters, taking all these factors into account?

Management: I can give a broader view on this. We have always said that we have 2 businesses. One is the core business, which is the wheels business. We would like to grow at a slightly higher

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pace than industry growth. We cannot afford to be exceptionally aggressive here, but we can clearly identify themes of growth within the sector's growth.

The area where we will clearly have an advantage is diversification. The 52% growth that I mentioned in the new businesses is due to the base effect and the fact that we are still early in the process, although we have made investments over the last couple of years. That is the advantage in the overall growth.

I am not changing our posture of 16%–18% medium- to long-term AUM growth. That remains broadly constant.

Renish – ICICI: Understood. So there is essentially no derailment because of these near-term challenges?

Management: We will be responsible. If we see tractors falling off, we will of course not go against the tide. We will factor that in. As I said, the wheels business, which is still 80% of the lending business, will have to factor in the macroeconomic environment.

We will not chase growth at the cost of either price or risk. Our aspirations are always adjusted for risk and price; they are not about growth for the sake of growth.

Renish – ICICI: Understood. This is very helpful. Thank you, and best of luck.

Management: Thank you.

Operator: Thank you. Our next question comes from the line of Kunal Shah with Citi. Please go ahead.

Kunal Shah – Citi: First, with respect to the overall credit-cost trajectory and the way it has developed in the first half, we have hardly seen any seasonality compared with Q4. GS2 plus GS3 is broadly stable, and generally the second half is significantly better for us.

However, given that there has not been much of an increase this time, the pullback could also be limited. Are we confident about the credit-cost trajectory, such that it should continue below 1.5%? Or would you be slightly concerned in this kind of environment, with below-average monsoons and the overall macroeconomic situation, and could we see some kind of an increase in Q3?

Are you reasonably confident because you have generally guided for credit cost of 1.3%–1.7%? We are at the midpoint of that range in the first half, which is generally elevated. Does this give you confidence that we can be in the 1.3%–1.5% range, or do you still see some risk on the credit-cost front?

Management: You are right. Typically, the franchise would see a hockey-stick pattern in Q1 and Q2, followed by a decline in Q3 and Q4. The fact that we have kept GS2 and GS3 numbers stable would mean that we would not see a similar complete drop-off in Q3 and Q4 because of the existing stock.

At the same time, in rural and semi-urban areas, cash flows improve in Q3 and Q4. Therefore, if things remain stable at the macro level, we might still see stability in GS3 as well as credit cost

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remaining in the same range.

However, I want to mention that we have given a range of 1.3%–1.7% for credit cost. I do not see any near-term or long-term challenge to that range.

I also want to remind you that we created some specific buffers in Q3 and Q4. Specifically, in Q4 we created a buffer for El Niño and the West Asia crisis. The total buffer is {? 852 crores ?} of overlays. We have 852 crores.

It is not that we will simply use this to smooth the numbers. These buffers were created with the understanding that there could be disruptions. If those disruptions become material, we may have to draw on them. However, right now I do not want to change any guidance regarding our credit-cost range of 1.3%–1.7%.

Kunal Shah – Citi: If conditions improve, would you not see any further need to create the buffer? Are we comfortable with the 852 crores we have, and will we continue to maintain it? If credit cost structurally declines to 1.3%, would you still build the buffer?

Management: These are always dynamic situations. We will have to assess the environment and plan accordingly. At present, considering the early vulnerabilities we saw in Q4 last year and the immediate issues at that time, including the West Asia crisis, which had just begun, along with the El Niño situation, we were compelled to create the buffer.

Right now, we are well buffered with overlays of 852 crores. I do not see any need to create additional buffers at present.

Kunal Shah – Citi: I have a couple of data points on trade advances. When we look at the entire “others” component, which has increased from 5.3% to 8.2%, would that 2.9% increase primarily be trade advances? Last time, trade advances were 2.2%–2.3%, based on what was reported between Q1 and Q2 of last year. Has there been a higher level of trade advances during the quarter, or is there another element in “others”?

Management: To be accurate, could you tell me which page you are referring to?

Kunal Shah – Citi: I am referring to the AUM contribution from “others,” which is 8.2%. In June, it was 5.3%. Similarly, last year, the June number was 5.2%, which increased to 7.5%. That was a 2.3% increase last year. This time it is 2.9%. I want to understand whether this increase is primarily due to trade advances.

Management: Your observation is right. Trade advances are the additional component there. I want to quantify that this year, based on our assessment of seasonal requirements, and because we are looking at higher growth, trade advances serve as the grease for achieving higher growth in Q3, specifically during the festivities.

Your observation is right: the quantum of trade advances we have deployed this year is clearly {? clipper ?} above normal.

Kunal Shah – Citi: That gives better visibility on growth.

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Management: Besides trade advances, we are also doing personal loans in our existing customer base. Personal loans are another factor. I would not say that they are as significant a constituent of "others," but they are also building up.

Another component that you will see building up, which I will separately identify, is our prime housing business, which we started in August. It is still very early, so it will not be a significant part of the 8.2%.

Kunal Shah – Citi: It will not be a significant contribution to the 8.2% at this stage?

Management: It will not be. However, I will start calling it out in the quarters from here onward because we have plans for that business.

Kunal Shah – Citi: Thank you. That is helpful and answers all my questions.

Management: Thank you.

Operator: Thank you. Our next question comes from the line of Kriti Tripathi with NVS Brokerage. Please go ahead.

Kriti Tripathi – NVS Brokerage: Congratulations on a strong set of numbers. We have seen 75% year-on-year PAT growth in Q1 and 61% in Q2, with disbursements growing 22% and overall business assets growing 15% in Q2.

Can we expect a similar growth trend to continue over the next 2–3 years? That is my first question. My second question is, what are the key factors driving this turnaround? My last question is, what is the differentiating factor compared with peers?

Management: There are quite a few questions packed into one. Let me clarify that PAT growth is not sustainable at these 70% levels. We are clearly a franchise where, if you look at our AUM growth, we are indicating 16%–18%. Typically, everything flows down from there. We need to recognize that the franchise and the loan book generally guide everything else.

The current PAT growth, which is at a high level, is also, in many ways, due to the credit cost that we are seeing unfold. GS2 and GS3 numbers are almost at their all-time lows. I do not think there is much more room for us to reduce them beyond this.

Credit cost has been optimized. We can optimize OPEX to some extent, but otherwise, if revenue growth and the loan book are going to grow at 16%–18%, you can almost use that as a proxy for income growth.

We are a franchise that wants to grow in the high teens, as we have said. We believe that, for a secured franchise, this is the right positioning. We have quarters like this that produce very high PAT levels, but those numbers have to be read in the context of what credit cost has done to the equation.

Your second question was about the key factors driving the growth. Could you repeat the second question?

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Kriti Tripathi – NVS Brokerage: I would like to understand the key factors driving this kind of growth in the company.

Management: To grow at 16%–18%, there is nothing particularly extraordinary involved. Any player that has been around for 20 or 30 years should be able to deliver that. The underlying commerce has to be strong. If the underlying commerce is strong, that will be reflected in disbursements and loan growth.

I want to make sure that we are audible because there is some noise—

Kriti Tripathi – NVS Brokerage: Yes, you are audible.

Management: We are a group of experienced professionals. This franchise has had very sound management in the past, as well as some new management that has joined. All of us are aligned towards one objective: achieving steady, structural, linear growth.

That is the objective we have. Given the path we have followed for many quarters, we see ourselves continuing to progress in that direction.

Regarding the question on peers, I am not best positioned to answer on behalf of peers. I am sure their results speak for themselves.

Kriti Tripathi – NVS Brokerage: Thank you.

Management: Thank you.

Operator: Thank you. Ladies and gentlemen, in order that management is able to address questions from all participants in the queue, you are requested to restrict yourselves to one question and one follow-up only. If you have further questions, you may rejoin the queue.

Our next question comes from the line of Avinash Singh with MK Global Financial Services Limited. Please go ahead.

Avinash Singh – MK Global Financial Services Limited: My question is about your mortgage business strategy. You are now folding your housing finance subsidiary into the parent NBFC.

If I look at the 2 sets of competitors, on one hand there are banks, which have a structural cost-of-funds advantage. On the other hand, HFCs typically also have some benefit from NHB refinancing. In that competitive environment, what are your plans in terms of the product segment, customer segment, or geographies in which you are trying to operate to scale up this business?

These 2 sets of competitors have a cost-of-funds advantage that will work against you on a relative basis.

Management: I will lay out the rationale for our mortgage aspirations. We are not a new participant in the mortgage franchise. As you know, we have had a rural housing finance company for the last 17 years. While it had a very good and solid start, it has faced some challenges over the last 3–4 years following COVID.

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The rationale for mortgage is that we believe there are 3 or 4 revenue pools that are extremely compelling from a lending standpoint. Mobility is where we have our dominant share. The second large pool is clearly mortgage and SME.

For a franchise of our size and scale to be absent from such a meaningful and growing category is not something we thought we should do. That is the rationale for participating in mortgage.

Regarding how mortgage is better suited to an NBFC or an HFC, and why we are choosing the NBFC route rather than the HFC route, these are meaningful questions. I spent time on this last time, but I will quickly reiterate the point.

We believe there is merit in simplifying the distribution of mortgage businesses, irrespective of the legal form in which they operate. In our assessment, the arbitrage between an HFC and an NBFC is going away to a large extent for the mortgage participation that we plan.

We plan to operate in affordable housing, loans against property, and some segments of prime housing. With all these categories, we believe that our overall return profile, given our medium-term target of a 2.2%–2.5% ROA, will not be permanently diluted by mortgage.

Mortgage may create some drag in the first few years, but in the long run, we are not here as a franchise for only 3–4 years. We have been in existence for 30 years, and we clearly plan to be here for the next 30 years and beyond.

Mortgage is a compelling area of participation in that context. We will ensure that the initial drag associated with a business like mortgage is managed. You are right that it does not have the most attractive ROE profile. However, many of our wheels customers today require an affordable mortgage loan in semi-urban and rural areas, and we are currently unable to offer that product.

There are clear merits to the strategy. We have 400 branches in MRHFL and 1,400 branches in MMFSL. There is duplication between them, and our strategic view is that participation will be simplified and duplication across various functions will be reduced.

Management: Overall, this is a category that is extremely attractive for us to participate in over the medium to long term. Sandeep, would you like to add anything?

Sandeep: No, I am fine. Thank you. I think we can take the next question.

Avinash Singh – MK Global Financial Services Limited: I have one more question. I remember that you answered this a couple of quarters ago. Going back a couple of years, co-lending was one part of your strategy to address super-prime customers in the new-vehicle segment. It could also generate fee income.

Given the regulatory changes, is that co-lending arrangement still part of your business plan, or has it been shelved?

Management {? Raul ?}: We had already started down that path, and we were doing co-lending on a monthly basis with some of the large lenders for certain businesses.

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As you all know, between CLM 1 and CLM 2, the regulations changed. The current framework requires both the senior and junior partners to be connected through their systems, with the systems seamlessly orchestrating the loans.

Under the new regulations, we have not yet been able to restart the process. However, my view has not changed regarding participation in the prime business through co-lending.

When I have an update for you on our going live, I will share it. It is currently in preparation. We are working with a couple of banks on systems integration. Once it is live, I will provide further commentary.

It is very much part of our participation in prime businesses. We definitely believe that we offer much more than just balance sheet capacity. We also offer distribution. As distributors, we are being approached by many senior lenders to make inroads and bring in customers more efficiently.

Once we are live under the new CLM 1 framework, I will provide further commentary.

Avinash Singh – MK Global Financial Services Limited: Thank you.

Operator: Thank you. Our next question comes from the line of Abhijit Tibrewal with Motilal Oswal. Please go ahead.

Abhijit Tibrewal – Motilal Oswal: Good evening, everyone. Thank you for taking my question. Going back to asset quality, you have commented considerably on some of the states that have declared droughts.

If I look at Maharashtra, it is a very large and important state for all lenders. Qualitatively, how are collections developing for the tractor portfolio during these first 20 days of October?

A related question is this: in the past, when we have experienced droughts or poor monsoons such as this year, how many quarters does it conclusively take to determine whether we are seeing asset-quality deterioration due to weak monsoons? Alternatively, could we say that we are comfortably past the difficult period and can look forward to the monsoons next year? That is my first question.

Management {? Raul ?}: Abhijit, why do you not finish your questions? I will answer them together.

Abhijit Tibrewal – Motilal Oswal: My second question is for Pradeep. In this quarter, we have seen a few AAA-rated NBFCs report a decline in their weighted-average cost of borrowings despite an increase in incremental borrowing costs.

What is our liability strategy here? Are we planning liability-side interventions that can limit the impact on the liability franchise over the next 1-2 quarters in a rising-rate environment?

My last question is also for you. We have already seen 10 days of Navratri, and you also spoke about higher trade advances. How are rural cash flows, and how has the festive season started?

Management {? Raul ?}: I will take the first and third questions and hand over to Pradeep.

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On asset quality, your observations are right. Maharashtra is a significant state for our business. If the question is specifically about tractors, given that the stress we foresee may be related to the drought situation and quite a few districts have been declared drought-affected, I would still say that it is early days for us to draw conclusions.

Our tractor portfolios in agrarian areas typically have a half-yearly installment. The half-yearly installments are scheduled when there is price discovery, usually around the end of the winter crop season and the end of the monsoon crop season. We are not at either of those points right now.

In a couple of months, we will reach the half-yearly collection period. Therefore, I am not currently able to provide a half-yearly update on whether we are seeing early stress.

However, in a drought year, I would not be surprised if farmers' priorities changed. As I have mentioned in the past, our collection philosophy is fair but firm. We do not follow a one-size-fits-all approach. Our collection teams in Vidarbha and other areas are meeting customers, evaluating the level of stress each customer is experiencing, and factoring that into our collection plan.

As a responsible lender, we will acknowledge situations where there is immediate stress and be accommodative. I am sure you have observed the franchise for some time now, Abhijit. Delay and default are very different things. Delay is not equal to default.

A delay may result in an increase from GS2 to GS3, but tractors remain one of the most attractive ROA products across the cycle for me. Therefore, we do not see a change in our stance towards tractor participation. There may be temporary delays, but that does not necessarily result in long-term defaults.

Coming to your question on Navratri, regarding the first 10 days, I want to be clear that underlying commerce has not been as strong as it was at the same time last year. We have seen some departure from last year's levels.

However, one needs to understand that last year's commerce was also exceptionally high because there had been a lull before the GST-related and festive demand surge. Last year's numbers have to be read in the context of all the pent-up demand being concentrated in those 11 days.

I will not give exact numbers, but I would say that there has been a decline from last year in both underlying commerce and underlying unit disbursements during the first 10 days. It has not been uniform. My early reading is that tractors have seen a somewhat greater decline than last year.

Pradeep?

Pradeep: Looking at the results of peer NBFCs, we understand that one NBFC reported a lower cost of funds. At MMFSL, we undertook significant interventions last year itself and optimized our borrowing mix in terms of instruments as well as tenor.

After optimizing our cost of borrowings last year, we do not expect our cost of borrowings to decline on a quarter-on-quarter basis in the coming quarters. In response to one of the earlier questions, I clearly explained how a 25-bps increase translates into our floating-rate borrowings, while incremental borrowings are also refinanced at a higher cost.

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Overall, I believe that our cost of funds will move on an upward trajectory. That is our guidance.

Abhijit Tibrewal – Motilal Oswal: Understood. This is helpful. Thank you for taking my questions, and I wish you and your team all the best.

Management {? Raul ?}: Thank you, Abhijit.

Operator: Thank you. Our next question comes from the line of Piran Engineer with Citic International. Please go ahead.

Piran Engineer – Citic International: Congratulations on the quarter, and thank you for taking my question. Going back to the AI-orchestrated disbursement of 1,600 crores, what exactly does that mean? What is different about these disbursements compared with the others if they are not 100% digital?

Management {? Raul ?}: To provide some context, the major businesses using this process are top-up loans. We provide refinance loans to our existing customers, where we typically have no or very limited intermediation.

These are existing customers who take either used-vehicle loans or top-ups on their existing loans, as well as customers in our personal-loan business. These are the 2 major businesses within the 1,600 crores.

There are also some dealer-led businesses. After receiving leads from the dealer, there used to be considerable physical intervention. Now, parts of the back office, including our CPCs, are fully agent-enabled, with very little human intervention.

There is triangulation of data, and once the in-principle sanction is made, we can move from sanction to disbursement while bypassing many of the earlier physical-intervention steps because of these agent-enabled journeys.

That is the nature of what we call AI-orchestrated disbursements.

Piran Engineer – Citic International: How was the process for top-up loans earlier, given that the customer was already existing?

Management {? Raul ?}: Earlier, for a top-up loan, every customer had to bring in the vehicle, have it valued, and undergo a full re-KYC process. The loan executive had to repeat many of the same steps.

Today, some of the AI tools put the ability to value the assets in the hands of the customers. The number of steps or the use of agent-enabled toolkits is significantly greater in this used-vehicle business.

I am not saying that we have already reached the gold standard. The process has been agent-enabled in phases, and we see considerable additional scope, particularly in the used-vehicle and top-up businesses, to make the process as seamless as a personal loan.

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Piran Engineer – Citic International: Understood. Second, after a long time we have seen a meaningful increase in headcount. Is this simply people moving from off-role to on-role, or is it a genuine capacity addition?

Management {? Raul ?}: Read it in the context of our renewed growth plans in some of the wheels businesses. You will see the passenger-vehicle business growing at a very healthy pace.

We have added manpower only in locations where dealerships were lacking headcount. As you know, the wheels business is still a people-driven business. You have to be present at the counter and orchestrate credit.

Regarding the portion of our headcount that was off-role, we now have a program under which consistently performing off-role employees migrate to on-role when we see that their productivity norms and other requirements have been met.

You are right that our headcount had remained static for the last 2 years. With our renewed growth plans, one of our core pillars is now pivoting back to growth. Growth in the wheels business, SME business, and mortgage business will require additional headcount.

Although we still believe that the ratio of operating income to operating expenses can be maintained, these employees will be essential for our growth plans.

Piran Engineer – Citic International: Understood. That is all from my end. Thank you, and I wish you all the best.

Management {? Raul ?}: Thank you, Piran.

Operator: Thank you. The next question comes from the line of Gautam Jain with GCJ Financial. Please go ahead.

Gautam Jain – GCJ Financial: Good evening. Congratulations on a great set of numbers to Raul and the team. When will we merge our housing finance subsidiary? Are we waiting for approval, and when do we expect to receive that approval?

Management {? Raul ?}: As with any merger, there are a couple of milestones to be completed along the way. We are very much on track. We have received the lenders' approval, and we have received various other approvals that are part of the process towards the final objective.

There is still approval required from the NCLT and some regulators, but I do not see anything that would require a change in our overall plans. We are looking at June-July next year as a possible end-to-end target.

We will keep stakeholders informed if any of the minor milestones in between come under pressure.

Pradeep: The appointed date for the merger is April 1, 2024, and the effective date, as Raul indicated, is expected to be sometime in June-July. That is the target we are pursuing.

Gautam Jain – GCJ Financial: Are we seeing any synergies once it is merged?

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Management {? Raul ?}: That was the entire rationale for doing it. Otherwise, we would not have gone down this path.

Gautam Jain – GCJ Financial: May I ask my second question?

Management {? Raul ?}: Yes, please.

Gautam Jain – GCJ Financial: Considering the higher base of disbursements last year in H2, how should we view disbursement growth in the second half of this year?

Management {? Raul ?}: That is a very reasonable question because last year was a story of 2 halves. H1 was flat, while H2 was strong. This year, we hope it will not be the reverse of last year.

In H2, we would like to see growth return. However, we are aware that the base is significant, and therefore we will have to be mindful of how to achieve growth in a constrained environment.

Having said that, Gautam, we have a very strong execution team. That is why we are present in practically every part of the country, enabling us to achieve growth from all the areas where growth is available.

Management: We will try to achieve reasonable growth while keeping the underlying commerce in mind.

Gautam Jain – GCJ Financial: As of now, is there no risk to 16%–18% growth in the loan book?

Management: Gautam, 16%–18% is my long-term trajectory. I am not indicating 16%–18% quarter after quarter; it is our long-term trajectory.

Gautam Jain – GCJ Financial: I am referring to FY27.

Management: Again, we do not provide quarterly or annual commitments. We always provide a medium- to long-term outlook.

Gautam Jain – GCJ Financial: Thank you very much.

Operator: Thank you. Our next question comes from the line of Viral Shah with IIFL Capital. Please go ahead.

Viral Shah – IIFL Capital: Thank you for the opportunity, and congratulations on a good set of numbers. I have 3 questions, 2 of which are follow-ups.

First, you articulated the impact of insurance commissions, especially on the standalone business. How should we think about the impact from the MIBL perspective? I understand that this depends on the current draft remaining as it is.

Second, on the yield front, you mentioned that, on an incremental basis, you would have some flexibility to pass on increases in the wheels business in a rising-rate environment. Have you already done that, or would you do it after the festive season?

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Third, this is a follow-up. I know you and Pradeep have both guided on the cost-of-funds trajectory. Can you quantify where we could land if we are talking about a cumulative 75-bps rate hike, given the dynamics of priority-sector-linked bank borrowings?

Raul: Thank you, Viral. I will take the first 2 questions and hand over to Pradeep for the last one.

On insurance, I want to reiterate that I am mindful that the draft consultation paper represents a significant departure from the norm. We are significant distributors through both MIBL and our corporate agency.

If it comes through in its current form, there will be a reduction in our fee income. However, I am hopeful that there will be a meaningful amount of engagement among the various stakeholders. Let us wait for the final version before we provide a quantification.

At the same time, I must mention that a franchise like ours has been receiving the benefits of the corporate agency business for only the last 4-5 quarters. As you have seen, Viral, in some of our new branch distributions, we were never selling retail insurance through branches. It was not simply bundled insurance.

The benefit from bundled insurance has come through, but we are still at an early stage from a scale perspective. Therefore, some of the income that could be reduced from the current business model may be offset because we are still at an early stage in terms of monetizing the franchise through broader distribution.

Hopefully, that will add and incorporate more revenue through the expansion from limited coverage to the growing coverage we have unlocked through our branch network and other forms of holistic insurance distribution.

MIBL is a very meaningful player in motor insurance. The initial suggestions regarding third-party and own-damage insurance represent a significant reduction. We will have to see how best to participate whenever the new regime comes into effect.

Therefore, it is a wait-and-watch situation. However, there is a shift in fee income between the earlier business model and potentially the new business model.

On the question of passing on rates, I would say that it is still early days, and we must remember that we are at the peak of the festive season. There is commerce, and there is competition for us to capture that commerce.

The rates have declined significantly in the salaried segment, in which we do not participate in any case. The competitive environment is extremely intense there. It is not as intense in the self-employed agricultural segments, where we still have some flexibility to price.

We have not immediately started passing on the increase immediately after the repo-rate hike, but we do have the ability to price in the increase to protect our NIM requirements.

Pradeep, please address the cost of funds.

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Pradeep: Overall quantification of the impact on the P&L, or where we would stand after a 75-bps hike, would be difficult. I will explain the reasons.

The capital markets generally take their cues well ahead of the actual rate hike. From that perspective, floating rates linked to the repo rate get reset with increases in the repo rate. Treasury-bill-linked borrowings and SLR-linked borrowings come with a lag.

The capital market also reacts ahead of time to geopolitical situations and inflation forecasts. In my view, some steepness in the curve has already been built in by the market in anticipation of further rate hikes.

Overall, I see an upward trajectory. However, at this stage, I will refrain from quantifying the exact impact on the cost of funds after a 75-bps hike.

Viral Shah – IIFL Capital: Understood. Thank you very much, and all the best.

Raul: Thank you, Viral. Just a request: we are running short of time and want to take all the questions, so please restrict yourself to 1 or 2 questions at most. We can remain engaged even after this call.

Operator: Thank you. Our next question is from the line of Punit with Dolat Capital. Please go ahead.

Punit – Dolat Capital: I have 2 questions. First, what is the duration of the book on the asset side, for both the vehicle book and the MRHFL housing book?

Second, bank borrowings are 51%. How much of that is linked to MCLR, and what proportion is linked to EBLR?

Raul: To be fair regarding our disclosures, I do not think we have provided the overall door-to-door maturity of the wheels and non-wheels books. We will see whether we need to include that in our investor deck going forward, but right now I do not want to provide a selective disclosure.

Regarding the 51% bank loans, do we have the MCLR-linked proportion?

Pradeep: We generally do not provide this breakdown. However, if you look at the floating-rate borrowings we have disclosed, at around 45%-48%, I would say that they are largely linked to the repo rate and treasury bills. MCLR-linked borrowings are lower.

Punit – Dolat Capital: Understood. If you cannot provide it by segment, could you indicate the approximate total maturity of the book?

Raul: Do we provide that, Pradeep?

No, Punit, we do not. We can connect offline and see how that information can be shared.

Pradeep: Punit, we have provided the ALF chart in our deck. From that, you can refer to the maturity profile of the assets and liabilities.

Punit – Dolat Capital: Understood.

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Operator: Thank you. Our next question comes from the line of Nidhesh Jain with Investec. Please go ahead.

Nidhesh Jain – Investec: How do you see the NIM trajectory developing over the next few quarters and next year? How do you plan the asset profile so that, in a rising-rate environment, we are able to protect NIMs from a medium-term perspective?

Raul: The variables available to us for influencing NIM are clearly on the loan-income and fee-income sides. Since most of our book is fixed-rate, what is already in the book is already in the book.

On the vehicle side, we will continue to be fixed-rate lenders. We will try to price in as much as required to compensate for the increase in incremental borrowing costs. That is the lever we have on loan income.

On fee income, we have made considerable progress through various channels, and we believe there is still headroom for further increases. For example, there is some headroom to influence processing fees, late-payment fees, and certain historical collection-related fees.

Overall, however, it will not be an extremely easy environment in which to achieve NIM expansion. As Pradeep indicated, we are in an environment where the cost of funds is increasing, and the levers available to pass that on are not completely one-to-one.

We will have to find mechanisms to grow the revenue pool while the cost of funds continues to increase. Overall, for the 2.2%–2.5% ROA that we highlighted, we clearly need to be above 7% from a NIM perspective.

At present, we are at the lower end of that range. However, I believe that the loan-income numbers do not accurately reflect the quarter. The half-yearly number is more representative of where we are, and we will find ways to protect the overall ROA and remain in the 2.2% range.

Nidhesh Jain – Investec: In the near term, is it reasonable to expect NIMs to fall below 7% in the coming quarters as the cost of funds is repriced upwards?

Raul: It will be challenging, but that does not necessarily mean it will happen. I did mention that there is currently a denominator effect in Q2 compared with Q1. One factor is the excess liquidity buffer, and the other is the trade advance, which is typical between Q1 and Q2.

That will go away quickly as the trade advances turn into commerce. The non-earning asset represented by trade advances will become an earning asset, and to that extent loan income will increase. The cost of funds will continue to present challenges.

Nidhesh Jain – Investec: The trade advance was approximately 3% of AUM, or 2%–3% of AUM, correct?

Raul: You can calculate that number from the disclosures. We do not provide it, so I do not want to specifically state that number.

Nidhesh Jain – Investec: Thank you. That is all from my side.

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Raul: Thank you.

Operator: Thank you. Our next question comes from the line of Rajiv Mehta with Yes Securities. Please go ahead.

Rajiv Mehta – Yes Securities: Most questions have been answered, but I have one point on end losses. End losses as a percentage have been around 1.2%–1.3% for many quarters. We have seen an improvement in flows, which is why bucket movement has been limited.

End losses have remained at 1.2%–1.3%. Should we also see some improvement in end losses with a lag if underwriting has improved, become tighter, and flows are improving? Should resolution recoveries also improve, or will it take time?

Is it a function of product mix because we have grown tractors over the last 2 years, and resolution recovery in tractors is generally lower across the cycle? How should we look at end losses going forward?

Raul: There are 2 components to credit cost: end losses and provisions. We have conducted our own analysis of the mix between these 2 components, but I do want to maintain our overall credit-cost guidance of 1.3%–1.7%.

We would like end losses to decline, but the fact is that, when vehicle prices change and we sell an asset, some assets may have had a certain residual value, while asset prices can decline and we may not receive the same value for the asset.

We believe that, to operate within a credit-cost range of 1.3%–1.7%, the current end loss of 1.2% is reasonable. It is not an abnormal level for the business to operate within.

We can clearly identify further efficiencies, and we will see how that number can decline further. However, for the current business model, we still have a significant amount of self-employed agricultural customers and others for whom these types of losses are part of the DuPont framework.

Rajiv Mehta – Yes Securities: On your comment about the festive season, you said it is not directly comparable because last year's Navratri also benefited from pent-up demand following the GST change. Even after adjusting for that, would you say the current period is somewhat softer?

If there is softness, can you distinguish whether it is more on the rural and semi-urban side and less on the urban side? Any color would be useful.

Raul: You can look at the Vahan data, which provides information by pin code as well as for rural and semi-urban areas for the full first half. In fact, rural growth across all categories was stronger than urban growth—

Rajiv Mehta – Yes Securities: Yes, I am listening.

Raul: The vehicle-registration data indicates that, at least through the first half and through the end of September, both rural and semi-urban areas were growing at a marginally higher pace than urban and metropolitan areas.

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Management: Although there are clouds above us in terms of El Niño and other factors, I do not think they have affected demand sentiment in these locations yet.

Some categories, such as tractors, will be affected. We have seen in the past that when there is a drought or scarcity, sentiment does get impacted. We will see some of that play out. However, at a macro level, I do not think we are currently discounting rural sentiment as a whole.

Rajiv Mehta – Yes Securities: Understood. Thank you, and best of luck.

Management: Thank you.

Operator: Thank you. Ladies and gentlemen, we will take that as the last question for today. I would now like to hand the conference over to Mr. Raul Rebello, Managing Director and CEO, for his closing comments.

Raul Rebello – Managing Director and CEO: Thank you, everyone, and apologies that we have gone approximately 10 minutes over our scheduled time.

As I said at the beginning, it has been an encouraging quarter. More importantly, the quarter reflects the considerable work done in the past across various outcome metrics, whether on the growth side, where we are growing both the core business and diversification businesses, or on the margin and risk sides. The quarter has been extremely encouraging.

More importantly, the trajectory we have seen over the last 3 quarters gives us considerable confidence that we are progressing well towards our F3I commitments: growing between 16% and 18%, keeping credit costs between 1.3% and 1.7%, and increasing the ROA profile from earlier levels to operate between 2.2% and 2.5%.

The trajectory is progressing well, and we are aware of the headwinds as well. We are happy to have a very experienced management team, including members of the earlier management team as well as some of the new people who have joined, to ensure that we are able to navigate these headwinds in a manner that keeps our long-term interests in mind.

Thank you again to everyone for joining us from different time zones. We are happy to remain connected and answer questions that we could not address during this discussion. Thank you.

Operator: Thank you. On behalf of Mahindra & Mahindra Financial Services Limited, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.

Note: {? ... ?} indicates a figure or name where audio clarity was insufficient for confident transcription. Verify against the source audio or the company's published filings.