"Bajaj Finance Q1 FY-19 Earnings Conference Call"

July 19, 2018

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Moderator: Ladies and gentlemen good day and welcome to Bajaj Finance Q1 FY19 Earnings Conference Call hosted by JM Financial. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Karan Singh from JM Financial. Thank you and over to you sir.

Karan Singh: Thank you. Good evening everybody and welcome to Bajaj Finance's Earning Call to discuss the first quarter results. To discuss the Results, we have on the call Mr. Rajeev Jain – who is the Managing Director, Mr. Sandeep Jain – Chief Financial Officer, Rakesh Bhatt – Chief Operating Officer, Mr. Atul Jain – CEO, Bajaj Housing Finance and Mr. Anup Saha – President (Consumer Business).

May I request Mr. Rajeev Jain to take us through the financial highlight subsequent to which we can open the floor for Q&A session. Over to you sir.

Rajeev Jain: Thank you Karan. Good evening to all of you. Our apologies for starting this late in the evening due to the annual general meeting of both Bajaj Finance in the afternoon and Bajaj Finserv late in the afternoon. I have some of my colleagues around the table that Karan has already introduced.

We have uploaded the investor presentation deck on the website and we will refer to that for the purpose of this investor call. I will request you to jump straight to section 1 of the investor presentation, page #13. Given that these are all financial numbers and given the transition from previous GAAP to IndAS and this is the first quarter that we are publishing these financials; we've provided previous GAAP data which is section 1 and then we have provided IndAS financials which is section 2. Given that there are all essentially numbers I am going to request Sandeep Jain to slowly go through section 1 and section 2. He will first go through previous GAAP then go through IndAS and I will come in at section 3 which is about nonfinancial commentary and some of the important slides and then we are ready to take questions.

Sandeep Jain: Slide #14, before I start talking about the numbers based on Indian GAAP which is not the standard that we will incrementally follow for reporting, let me just read out the disclaimer. This is the first time that we have adopted Indian Accounting Standards and to facilitate comparability of numbers and to help you understand the performance of the company in the way you used to see earlier, we have worked out the Indian GAAP numbers. This will give you the view of the core growth that the company has delivered in the last quarter. These are not the numbers that have been audited or have been subjected to review by statutory auditors.

As we closed Quarter 1 which was on 30th June, 2018, we have seen 30% growth in our customer franchise. The customer franchise stood at 28.28 million as at the end of 30th June, 2018 which is up 30% from 21.69 million of last year same time. We have seen very good traction in new customers acquisition. We added 2.06 million customers in the previous quarter.

On new loans booked, we did record 5.63 million customers in the current quarter which was 49% higher than what we acquired in the last year same time.

Assets under management, this did not get impacted by IndAS in any given manner, came in at 93,197 crores up from 68,883 crores, which was a growth of 35%. Now, last year if you remember we had an outstanding IPO financing book which is typically a 3 to 4 days financing that we do, this was about 2000 crores, adjusted for this the assets under management actually grew by 39%.

Total income grew very strong at 37% at 4,276 crores for the quarter. Net interest income came in at 42%, thanks to the lower cost of fund also which was ~30 bps lower than tje last year same time. It came in at 2,904 crores for the quarter.

Loan losses and provisions for the Quarter 1 came in at 284 crores almost in line with 282 crore we had seen in the previous year, virtually no increase in loan losses despite a 35% asset growth in one-year time.

Profit after tax, as a result, which is the core profit—let me call it core because it is based on previous GAAP that we are used to seeing—came in 69% higher at 1,018 crores for the quarter versus 602 crores that we delivered in the last year same time.

Consolidated GNPA and NNPA, of course there is no change in the definition of gross nonperforming assets on transition into IndAS, came in at 139 basis points versus 170 basis points in the last year. Because of expected credit loss provisioning that we are required to do in IndAS, there is some change that is happening on net nonperforming assets percentage. The number as per Indian GAAP, if we were to calculate it as per India GAAP, came in at 37 basis points. We had a provisioning coverage, assuming we pursued previous GAAP for the current quarter as well, at 74% as at the quarter end.

Return on assets and return on equity remained very solid at 1.2% and 6% non-annualized basis respectively.

Let me jump to Slide #15 which is a very critical slide from this quarters perspective. This slide essentially gives the reconciliation of the impact that IndAS has caused on the financial results of the company. Let me talk about the format of this slide before I get into details. The first column basically highlights what kind of changes have happened because of IndAS migration. then you have column 3 & 4 which are basically Quarter 1 current year, Quarter 1 previous year, few items where growth have been explained and FY17-18 profit re-caste based on IndAS. Then the remark column which is self explanatory in that sense.

Profit before tax for Quarter 1, 2019 came in at 1,562 crores as per Indian GAAP. There are certain adjustments that have happened because of IndAS. The largest being amortization of processing fees, the subvention and the cost of acquisition over the tenure of the loan that had an impact of 221 crores on profit. This number is net, so you will have a larger number when you do calculation at upfront fees and inter-subsidy level and there is a benefit that comes in because of amortization of expenses that is also allowed under the IndAS, the net number is 221 crores. Similar to amortization of revenue and cost in loan book, IndAS also permits to amortize the cost of raising deposits or borrowing that we raise from the market and banks - That gave us a benefit of 8 crores for the quarter.

Expected credit loss is a new way of accounting for losses as defined in Indian Accounting Standards. It essentially hovers around the fact that one should not follow a particular percentage for determining what losses should hit the P&L. Every company is different, every financials are different and hence every company need to create its own metric to determine the expected credit loss and of course to be signed off by the auditors. It basically talks about the probability of default which means if I have 100 customers today, all current, how many of them would move into delinquency over a period of time and there are requirements around 12 months provisioning as well as lifetime provisioning. I will come to it.

Second is EAD, or exposure at default which means a customer who has an exposure of Rs. 100 today will go into losses, then will he go with Rs. 100 outstanding or Rs. 110 or Rs. 90 outstanding that's expected exposure at default. The last important metric is LGD or loss given default that if a customer goes into loss, what kind of recovery company would be able to make and what is the ultimate loss that the company will incur. All discounted at a present value; there is significant amount of complications that comes in because of that.

Now, based on the historical empirical data portfolio by portfolio we have created a very comprehensive expected credit loss model for the company by line of business. This has resulted in 37 crores of additional provisioning in the previous quarter. I would like to call out that if we were to differentiate between provisioning on nonperforming assets versus provisioning on standard assets, the provisioning on nonperforming assets have generally gone down on moving to expected credit loss model whereas the provisioning on standard assets because now we are required to make provisioning on a lifetime basis for a 12 month loan product example consumer electronic, and for other longer tenor products where the customer has moved into 1 EMI and 2 EMI default. As a result the standard asset provisioning at a portfolio level has moved significantly from 40 basis points to 90 basis points approximately. That has effectively resulted in a hit of 37 crores for the quarter.

Apart from these, there is fair valuation of ESOP option which we were doing earlier as well but it was not required to be put in the P&L. IndAS requires it to be routed through the P&L, rest of the numbers are smaller in terms of impact.

The profit number for the quarter instead of 1,562 crores pre-tax, as a result of IndAS transition, came in at 1297 crores, post-tax came in at 836 versus 1,018 crores that would have been the number based on Indian GAAP.

FY 18 number, as we recast the 4,096 crores of pre-tax or 2,674 crores of post-tax came in at approximately 6.65% lower on a full-year basis as we've re-casted our financials in IndAS. So that's the movement that we have seen on account of migration to IndAS. Interesting thing if you notice in the numbers, a significant amount of impact that you see in 2018 has actually got accounted in first quarter itself. So we did not see an incremental flow through of IndAS impact going in the balance part of the year which could also be the case in the current year as well. Of course given that we are also very new to IndAS it's very difficult to put pen on the paper and project IndAS numbers. But looking at the last year's trend, all goes well we should see similar kind of performance.

Let's quickly moved to section 2 which is IndAS financial performance for the quarter; I will not be picking up all numbers. Let me talk about numbers which have changed on account of IndAS transition. Net interest income on account of IndAS transition has moved up to 46% growth at 2,578 crores taking into consideration amortization of revenue and cost pertaining to asset side as well as liability side of the balance sheet.

Loan losses versus 284 crores in Indian GAAP for the Quarter 1 actually worked out to 327 crores under IndAS model. As we recast last year number as well, the growth in the loan loss number was nearly 7% versus a balance sheet growth of 35%. Profit after tax came in at a record 81% for the quarter 836 crores. Apart from that as I mentioned about the gross NPA, net NPA, the definition for gross NPA has not changed so the number remains at 139 basis points as per Indian GAAP as also in IndAS. However the net NPA because of provisioning standard change has increased from what we would have reported under Indian GAAP of 37 basis points has actually came in at 44 basis points in Indian Accounting Standard. So that's only 6-7 basis points moment in net NPA.

Deposit book grew at a very healthy pace at 9,427 crores it was the growth of 85% and at 14% of the overall standalone borrowing that we had in the company.

Very happy to announce that company has been again ranked as one of the best companies to work in India by Great Place to Work. This was the 6th year in the row that we have been recognized with this kind of ranking.

Now let me move to Slide #18 which is basically consolidated profit and loss statement for Quarter 1 2019. We have tried and covered, given that this is first time that we are seeing IndAS financials, a detail commentary in terms of how one should look at the variances in the financials. All the numbers that you see here have been re-cast even for last year based on Indian Accounting Standard.

Total interest income and fee income came in 39% higher at 3,941 crores, very strong traction that we have seen in fee revenue pool across the insurance business that we do, distribution that we do for CCP, value added services products and so on and so forth. Similarly on account of amortization of cost related to acquisition, the number came in very strong.

Interest cost saw only 27% growth on account of two reasons, one of course we raised capital in September last year, so there is a benefit of additional capital sitting here plus also the cost of fund has also come down by around 30 basis points. Additionally, IndAS has provided a 8 crores breather in the quarter. The interest margin as a result came in at 46% higher. Operating expense was a big surprise, came in at 28%. We have seen a significant operating leverage across most businesses in the company, that's one. Secondly, last year same time we had incurred some one-time expenses of about 25 to 30 crores towards advertisement other initiative that we had taken plus of course the point that Rajeev keeps on mentioning about the prudent OPEX management I think it has have really played out well for the company. That has again given us benefit on operating expenses. And the last point is, which is most important, as we transition our business of mortgage into housing finance company, Rajeev did mention in the previous quarter that we have pruned about Rs. 50 crores of cost in the business while transferring it to the housing finance company.. These are costs which have been completely taken out from the company., Just to clarify that 50 crores number is annualized number. Loan losses number, loan loss provision came in at 7% as I've explained. As a result the growth is 81%. Loan losses to AUM came in at record low of 35 basis points for the quarter, last year same time was 44 basis points.

Another important point I think all of you will have in your minds is basically what kind of impact did IndAS caused as we transition into the new reporting standard. We have given a reconciliation of opening reserves and surpluses as of 1st of April, 2017. Though the IndAS reporting starts from 1st of April, 2018, the transition date is 1st of April, 2017 which is previous year. Opening reserve as on 1st of April, 2017 or 31st of March, 2017 was 9,491 crores. Various items that I explained for Quarter 1 variances appear here as well. Adoption of effective interest rate method for accounting of income on lending balance sheet gave a impact of 797 crores as a onetime impact as on 1st of April, 2017. On the borrowing side we have seen 79 crores of impact, positive this time because we have amortized the cost of raising of deposit as well and borrowings, 79 crores benefit came in. Expected credit loss mainly on account of additional provisions required on standard assets gave a negative impact on reserves of 270 crores. Valuation of financial asset that is fair valuation through P&L gave 46 crores benefit in the reserves. The important point to note here is that even after migration to IndAS, the value of the reserve is down hardly 5%-6% and the most important point to note is with the movement of IndAS and the expected credit loss, while we were very clear earlier that the provisioning standard that we were following for loan losses was ensuring that our P&L is fully costed. ECL is actually ensuring that not only the P&L is fully costed but even the balance sheet is fully provided for the potential losses that may hit us or emerge from the business that we do.

Slide #20, and after that I will hand over to Rajeev, is basically to give you a view as to if we were to report the last year financials on a quarterly basis as per IndAS, how the trend line would change. The left block is the previous GAAP PAT on a quarter-on-quarter basis, you see cyclicality playing out; 602 crores in Quarter 1, going down to 559, going up to 768 and again going down to 745 as we go towards Quarter 4. In the IndAS regime what will happen is because the expenses and upfront revenue etc. is getting amortized over the tenure of the loan, you see a pattern emerging in terms of performance of the company, 461 gradually goes up every quarter and reaches 748 crores as we sign-off the year 2018. That's what I had to share on financials. I request Rajeev to take section 3.

Rajeev Jain: Thanks Sandeep. I will quickly jump to page #22 to non-financial commentary. Overall the first line is an important line that it's one of the strongest starts of our first quarter in last few years and actually as one of our vice-chairman says that "if you start your first quarter well, in general you land up ending well because its AR based businesses and it earns money through the year", so I think to that extent it's a pretty strong start.

BHFL is fully operational now, progressing well in terms of the transition that we had planned and we are quite confident and comfortable that business will deliver good growth as we build the model out from third to fourth quarter onwards.

BFL continues to focus on a standalone basis on the granularity of portfolio across products and geographies with the objective of fairly reducing risk and augmenting profitability. I think that journey even in Q1 just continued, it's one of the reasons it reflected in better margin profile, lower cost in general as the economics of our investments play out and better risk metrics. Clearly, if you reach existing customers and you are efficient in the way you manage it, there are higher-margin and lower loss. To deliver the granularity clearly you need to continue to grow distribution. We opened 150 odd locations between rural and urban to 1486 locations.

OPEX to NIM, Sandeep mentioned it; it is a little bit of surprise to us as well - so that we are all on the same page. We did tighten the screws on NIM, on OPEX expansion in November 2017. We put out hiring fees and so on and so forth in certain parts of the businesses, didn't expect that it will play out this well. So we are quite pleased with it but not taking it—I would just because that that's not the number we are going in—we continue to do the right thing. You accelerate, you decelerate, you accelerate-you decelerate. That's really how real businesses are run. So the real number would continue to be as I said as we did in the past that the number should be around 40% that is really what should be expected from a OPEX to NIM standpoint. But at one level it demonstrates if it's possible. Now this quickly is a surprise even to us. But it is possible; it is a lever that is available to manage business well.

ALM continue to be judiciously managed that's why despite the hardening in the bond market, hardening in bank, liquidity not being tight I think it has had no impact in Q1, clearly the micro is strong, macro is week, hardening interest rates is reality. We will see 2 to 3 maybe even higher rate hike as GST inflation also plays through the economy. So clearly we are in for a higher interest rate environment which in a transient basis will mean margin compression. It's not played through in Q1, not likely to play in Q2 but maybe from Q3 to Q4, by Q3-Q4 you may see some impact of margin compression play through the P&L.

Portfolio quality remained very-very strong. Q4 was very strong. If you refer through the slides where we talked about Slide #26-27 and we are now giving 9 quarter data. Actually if you do corresponding same time last year and the year before in most of the businesses if not all we are actually coming in better than where even we were last year and two years ago. And that's what is reflecting at the 7% loan loss growth in IndAS and in previous GAAP only 1%, so we are in a pretty strong position there.

MobiKwik wallet, we invested 225 crores last year, 2.2 million active customers, 3 million have downloaded, 2.2 million are active and we continue to work to mobilize our entire wallet strategy.

Point that is probably not here but should have been here is that the credit card business continues to move well. The company crossed 0.5 million credit cards in force and came in at 508,000 Bajaj Finserv RBL credit card ending June 30th.

The Board of Directors of the company today approved us creating another subsidiary which will be Bajaj Financial Securities Limited. The strategy clearly of that company is as some of you are aware that we are among the top 2 loans against security vendors in India to ring-fence our clients and to offer the same clients Demat and broking services to start with and augment in the process the profit pool of the LAS business. We have received approval from the board to have a separate securities company which will have offer Demat and broking to its captive customers. So that's a broad non-financial commentary.

Slide #23 very quickly, franchise route continues to grow well, 2 million new customers in the quarter, 28 million overall franchise, 16.5 million best customers, added 1.1 million customers. Slide #24 as I said 153 new locations got added, 1486 locations that we are now in business and these are not branches, these are locations and 70,000 points of sale that we now cover versus 64,500 points of sale in March '18. Slide #25 growth was pretty granular in the nature, consumer B2B grew 27%, B2C grew 47%, rural 75%, SME 42%; SME was a big comeback. We have talked about fourth quarter it grew at 19% odd. The year quarter prior 16%, the quarter prior 15%. So clearly post GST the flow is stronger as you can see in the latest slide that the performance has also turned around from a credit standpoint. If it sustains for a quarter or so I would say we are probably out of the woods and into a strong growth momentum that we used to be pre-demon.

Commercial lending, you see #32, there is an '*' there because there is an IPO financing business sitting in the previous year AUM, otherwise the core growth was around 69%. Mortgages at 27% as the BHFL gets its arms around the business more strongly by third or fourth quarter you should see much stronger growth.

The next #26 and #27 Slides are data on our portfolio quality; we remain in the business of risk. You see I will focus just on the color so other than the two-wheeler business most businesses are better than last year or the year before other than the two-wheeler. Two-wheeler is better than were it was in Quarter 3 and Quarter 4 but still behind where it was two years ago. Two years ago their current portfolio was 89.5; they are still at 87.6, so there is some still work to do there.

Slide #29 very quickly, this is provisioning coverage under IndAS by lines of businesses. B2B, overall company is 1.39% and 44 basis points. I won't go through the numbers but you see the high risk businesses, the low-risk businesses so mortgage at 56 basis points and 22 basis points where is you can have consumer B2B at 2.73% and 89 basis points and we continue to be highly prudent in a way we provision for them.

Last slide – Slide #30 and with that we will open it up for questions. Assets have grown to 93,000 crores. Overall opening GNPA came in at 1,164 crore, slippages were 379 crores, roll backs were 263 crore and net addition to the gross NPA in the process was 116 crores. So clearly if the micro improves you should see movement here that is the other way to look at this and gross NPA in the process came in at 1,280 crores. So if the micro improves you should see some momentum. This we say we are efficient but if the consumer gets better we will see greater momentum here. With that we opened it up for questions. I have my colleagues and myself here to respond. My apologies for a little longish opening remark but given the transition to IndAS we thought it's important that we go slowly and spend time on providing you detailed update. We are open for questions Karan.

Moderator: Thank you very much sir. Ladies and gentleman, we will now begin the question and answer session. The first question is from the line of Nischint Chawate from Kotak Securities. Please go ahead.

Nischint Chawhate: You mentioned that standard asset provisions about standard asset provisions equivalent under the ECL would work out around 89 odd basis points. So if maybe you could just explain what it is and how would it change over time whenever the greens turn amber etc.?

Sandeep Jain: Basically, ECL requires as I mentioned to make provision based on estimated losses rather than a particular percentage prescribed in the rules and regulations. ECL has defined in three stages, stage 1, stage 2, stage 3. Stage 1 essentially is set of customers who are current and who don't have any default, stage 2 is set of customers where the customer has one or two installments overdue, they have still not slipped into NPA bucket and stage 3 is nothing but NPA account i.e. more than equal to three installments overdue. In case of standard assets in bucket zero, for a moment, which is stage 1, the ECL requires you to make a provision on 12 month forward basis. Which means you make projection as to how many customers will default in 12 months time and as a result what kind of lifetime losses that they could give to the company based on empirical data. That's one way of providing it that's where the number is probably 45-50 basis point. The second stage which is bucket 1 and bucket 2 - one or two installments outstanding, there the ECL requires you to make a provision on a lifetime basis which means on the day when a customer moves into bucket 1 or one installment overdue have to provide for lifetime losses and hence the number can moved significantly from 40 basis points which was regulatory requirement earlier to almost 89-90 basis point which was an outcome based on the product level working that we did on expected credit loss. The most important thing to focus on is the credit portfolio quality which is given on Slide #26, 27,28 where most of the businesses, if not all, have improved in terms of portfolio quality. Their current bucket performance has gone up….

Rajeev Jain: They were to deteriorate; you would see ECL play out and Stage-2 leading requiring higher provisions, so what used to be happening at 90 days are due will now start happened that stage 2. So account is not even delinquent and it will require you to provision.

Sandeep Jain: I think one more point that you can note is last year if you see Quarter 1 it showed a 13 crores impact on account of migration to ECL by the end of the financial year 2018 the impact came in positive 9 crores, so depending on the portfolio composition the numbers can move.

Nischint Chawhate: Any sense you could give as to some sensitivity around when the green turns amber or amber turns red how this number could move like?

Sandeep Jain: I think one will have to create his or her own models to figure out the impact of ECL; ECL is a new way of looking at provisioning. It will be difficult at this point to comment on it but as we progress on this journey of IndAS, maybe over Quarter 2 or Quarter 3, we'll have more clarity that we would be able to share.

Nischint Chawhate: The other point was on basically expenses, you mentioned that you got to 50 crores benefit during because of the transfer of book to a different company.

Rajeev Jain: We restructured the mortgage business and took out 3 to 4 crores of cost per month is the point that's why I was correcting Sandeep that 50 crores is the annualized cost saved as a result of transitioning because you got to run a standalone pure play mortgage business as long as it is setting in the large umbrella of high margin standalone BFL. It could support, sustain and pay for it as the business moved to…so prior to moving the business we restructured the business and then transitioned it into BHFL. That's the point Sandeep was making and in addition the two more points that were being made one which I made that we did tighten our operating expense orientation in November. We had a freeze in the company for 5-6 month' period on non-branch head count and there was an advertising campaign that we ran last year which were booked. So all this totaled up to the overall operating leverage that came through in Q1.

Nischint Chawhate: I am not sure if you've shared this, the net worth as on March '18.

Sandeep Jain: We have not shared specific number Nischint but the impact on March '17 or 1st April, 2017 was 612 crores post tax. and the impact that has been shared on Slide #15 is basically 2,674 crores of profit as per Indian GAAP for last year getting re-cast to 2,496. Sum up these two numbers I think 780 to 800 crores is the impact that one would see on reserve and surplus as of 31st March, 2018.

Nischint Chawhate: Can you share the June '18 number or I can do just math?

Sandeep Jain: June 18 is additional 200 crores impact, 182 crores to be precise.

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

Agastya Dave: I wanted to understand a bit more about the underlying assumptions when we calculate through the IndAS route. First is the discount rate that you use, if you could share that I mean what are we talking about here, how much is the discount rate?

Sandeep Jain: Discount rate is product by product.

Agastya Dave: The second is if you look at your entire portfolio including the subsidiary now, the mortgage business, in that entire portfolio what would be the loss given default, what is that assumption that in case a default happens what kind of loss I mean what is the underlying assumption there, what are you thinking? I think in these two questions, the discount rate and the loss given default what is your expectation in terms of the trend going forward I mean what will happen with let's say if there is a systemic problem and default rise throughout the industry, these numbers go up by how much? Given the calculations that you have done what kind of additional cushion do you have with respect to what really will play out? The third part of this question is that the standard asset provisioning has gone from 40 to 89, now this additional 49 what is the regulatory treatment for this? Will your regulatory calculations be done on a different set of accounts or will it be on these numbers only and will it be considered as T1 or will it be T2, what's the impact there? And finally, again on IndAS in one of the slides I forget which one you've mentioned the number 797 crores so that is the net tool outstanding of unamortized fees? Is my understanding correct?

Sandeep Jain: Yes, so let me go point by point. You asked first question about discount rate, discount rate is not used at company level; it's used at product level. The internal rate of return (IRR) of the particular loan, let's say if I take an example of consumer durable loan - we do the business at 24% IRR, 24% is used as discount rate. If you are talking about home loan which is done at 8.5% IRR, 8.5% is used as discount rate. That's how it is done. In case of loss given default, we have used empirical data product-by-product. Again, it is not a broad brush that we can use one (LGD) loss given default at company level. Again, there are nuances at product level that one has to go through. It may be different for a consumer electronic product to a two-wheeler lending to a home loan product. We may have a scenario where home loan product may give an LGD of 10% or 15%, which is the ultimate loss that we will incur on the customer - maybe only 15% of the amount that was outstanding when the customer went into default. Versus this, in a consumer durable loan or two-wheeler loan which can have LGD to the tune of 80% also. Which means the customer when he defaults with a Rs. 25,000 outstanding, we may be able to recover only Rs. 5,000 from the customer and the customer goes actually into losses. So, it is again being done at product level and not at a holistic level.

Rajeev Jain: If we runs 25 different lines of business, that is 25 different models that are being created and that comes without a point. What is the impact on the company will be an outcome and more granular the portfolio and more distributed the business, less will be the impact in general.

Participant: Yes. Actually, that was the question here. As granularity increases that get captured, right?

Rajeev Jain: Of course, it is getting captured, yes. Of course, it is getting captured.

Sandeep Jain: Now on your question on regulatory reporting and provisioning on standard assets - loans which have zero to 2 EMIs outstanding. In the absence of any clarification from RBI at this point in time and the way the current potential norms read, all the provisioning made on these customers have been taken as Tier-II capital for the purpose of capital adequacy calculation. Other than that, there is no change. Anyways, the cost has to go into the P&L that is what has been done. The onetime impact, as of 31st of March 2017 has gone into reserves - that is a transitional provision that has been given in IndAS. Your last question was on Rs. 797 crores of amount which is in the calculation of opening reserves. You are right, that is the unamortized portion of the upfront fees, subvention, and the cost that we have incurred for acquiring those customers and it is given as of 31 March 2017 - it is a net number. It has gone up by Rs. 197 crores in 2018, it has gone up further by Rs. 221 crores in the current quarter of this year….

Rajeev Jain: Which is the point that Sandeep was making, that in general because, as we shared on Slide #20, that we see the impact of it play in the first quarter on a full year basis. So, that is really how you get that.

Participant: So, will this number continue to diverge or will it become a constraint number which will not grow? I mean, probably try this to let us say 2 years down the line it rises Rs. 2,000 crores and then stay stable at Rs. 2,000 crores? Or will it be like vanishing over a period of time?

Sandeep Jain: If we continue to grow well and we do have aspiration of growing well and if we keep the portfolio mix the way it is today the number will keep going up. However, if there is a drastic increase in the portfolio mix wherein a product which has a very small amount of processing fees then you see that this number probably go down as well.

Rajeev Jain: So, if the mix does not move this would not move. So, our view on the business may not change but just the mix may change as a result of external environment or internal view this could change.

Sandeep Jain: So, there are multiple variables. So, if we reduce the processing fees that we charge to the customers or increase the cost of acquisition then this number can further go down.

Rajeev Jain: That is structural change that one does not want to make - the change for the sake of accounting.

Participant: Okay. Final question, sir. Great operating leverage again on the P&L. How much operating leverage is just too much? I mean, is there a upper limit of dollar NII that you can generate per employee? At what level do we start seeing again a bit of catch-up happening on Y-o-Y?

Rajeev Jain: Look, so I mean, given the strong growth, as I said, we did put a freeze in November. It is more from a culture orientation standpoint rather than cost. With the profit growth like this, we do not need it, okay? But we were the ones as a management 2 years, for the last 2 years we were saying let us build out the talent, technology, let us invest, invest, invest, invest. There comes a moment where you say more from messaging and less from, the company has to change course. Management is aligned to it or the senior management on this table is aligned to it. But the company can start to behave in a particular way. So, it is more messaging and to make sure that we just optimize that is the right word, let us just optimize and when the company responds very well in general. That is really the culture of the company and it responded very well. As I said in my remarks that I did not expect the company will respond so well. It is not that people need people and they are not getting people. we did added 153 branches, right? That means on an average we added 8 to 9 people are in each branch, which means we still added 1,200 odd people. So, it is just optimization rather than anything else, but it is played to us as well that it can be a lever.

Participant: Till what AUM will this be a decreasing function?

Rajeev Jain: Okay, I will simplify the conversation. 40% is the rightful number that we should hold at. As I keep saying to anything better than that it came into the profit pool - It could be in a quarter 42% as well. We just want to make sure that everybody knows that we are prudent in watching the line. We have reached a point. The only point I would make and some investors in the past have asked me that we have reached, and the size of the bubble is now large enough to optimize. So, is that correct? Yes. So, we will keep accelerating, optimizing, accelerating, optimizing, this line because it can mean operating leverage and profitability movement can be large. So, that is the point.

Participant: You said 40%, right sir? You said 40%, four-zero?

Sandeep Jain: Four-zero, that is correct.

Moderator: Thank you. The next question is from the line of Ashi Anand from Allegro Capital. Please go ahead.

Ashi Anand: I had a few questions. I am just trying to understand whole EIR impact a bit more. If I am assuming that the larger part of the EIR impact is because of amortization of upfront fees, I was just trying to understand what would cause the seasonality with the larger hit that is actually coming in Q1 because I am assuming upfront fees actually accrue over the entire year?

Sandeep Jain: The previous GAAP allowed the processing fees and subvention and costs to be accounted upfront. If we take an example, let us say of consumer electronic loan, we finance today Rs. 25,000 and get a subvention of Rs. 2,000 on this. This Rs. 2,000 is currently accounted or was being accounted upfront on the date of receipt. Under IndAS this Rs. 2,000 has to get amortized over the 8 months or 9 months tenure of the loan which is nothing but EIR based accounting. As we do that and the fact that quarter one sees more number of televisions and electronic products and washing machines and air conditioner being sold, you see the upfront revenue pool contribution go up significantly. As we move to EIR, these upfront fees has to be amortized and hence bigger impact in quarter one.

Ashi Anand: Sir, but would it be fair to say that the share of consumer durables is that much high in Q1 because even if I am just seeing EIR it is almost like 90% - 95% of the EIR impact coming through in Q1. So, just trying to understand, would it be fair to assume last year's trend to also continue into this year? Is that how season the business really is?

Sandeep Jain: That is correct. The seasonality is very high in consumer electronics business.

Rajeev Jain: First and the third quarter.

Sandeep Jain: First quarter and quarter three...

Rajeev Jain: First quarter over the last three years is larger than quarter three, yes.

Sandeep Jain: There is one season which is summer where lots of ACs and refrigerators are sold. Second season is Diwali when lots of festival buying happens. So, the number moves up significantly.

Ashi Anand: Okay, excellent. And if I am just trying to understand the impact of this from say a longer-term period. As long as our growth is very strong so a share of new kind of loans where we would be having to kind of inserting the upfront fee income in one quarter we are taking it across the term of the loan, but we are also getting a benefit on the older loans where we are actually getting the amortization of the...

Sandeep Jain: That is correct.

Ashi Anand: Right, so we are really looking at the business mix, right? So, as long as we are growing very rapidly, this is negative. But if growth actually comes off this could actually move to a positive impact. Would that be right to understand?

Sandeep Jain: Only one clarification, when you are comparing Indian GAAP and IndAS, you call it negative. But every growth has a positive impact on the balance sheet and P&L over long to long period.

Rajeev Jain: No, that he understands. He is asking yes, that is correct. See, fundamentally, you are in a way if I could simplify that are you of the tread mill in the process that earn today and book today versus earn today and book over a period of 10 months? Yes. So, clearly, as one of the points that Sandeep also mentioned that not only does it strengthen the P&L, so we think IndAS is a right thing to happen. We were waiting, we thought IFRS would come in and it would allow us to do this transition. So, clearly, it is a right thing to happen. It will make the business much more stronger.

Moderator: Thank you. The next question is from the line of Hiral Desai from Anived Portfolio Management. Please go ahead.

Hiral Desai: I just wanted this clarification on the EIR for Q1. Out of this Rs. 221 crores, how much of that is impacted because of let us say short cycle products like consumer durables?

Sandeep Jain: So, Hiral, only one point. If you look at last year numbers, as I mentioned, quarter one impact last year was Rs. 186 crores, full year impact is Rs. 197 crores. Looking at these numbers, I have reason to believe and that is the reality as well, a significant portion of Rs. 221 crores is on account of shorter tenure loan which is consumer electronics, digital products and so on so forth and it will get even out as we walk through the year.

Hiral Desai: Just one more clarification. This Rs. 797 number that you have for FY 2017 results getting adjusted so if let us say, the FY 2018 number is negative Rs. 200 crores that reserve number or the negative impact will go up by Rs. 200 crores, is it?

Sandeep Jain: Yes, that is correct. But do not look at Rs. 797 or Rs. 221 in isolation. Look at the total impact.

Hiral Desai: Sandeep, there will be some rundown of the book also, right? Given that these are largely 6 months to 9 months' kind of loans. I am just trying to understand why is the number successively then going up because if it was a pool as of FY 2017 there would have been a decent rundown in FY 2018 also right, on the consumer durable book? It is a fast-churning book, right?

Sandeep Jain: That is correct. So, Rs. 797 crores as of 31st of March 2017 would have completely got recognized in 2018. But because we have also done business in the last year Rs. 797 crores plus Rs. 180 crores have moved into unrecognized income as of 31st of March 2018. So, the number has flown into the P&L but whatever business we have done in the last year has again created an unrecognized revenue pool.

Rajeev Jain: So, we have grown. So, the fact that B2B consumer business which is most of that is 27% and as part of rural as well there is a block that is sitting there. So, the point that Sandeep was making you are emptying the bucket from the past, but you are filling up the bucket. If you are growing the business that is not a problem. If you are not growing, what is the help? The management at our level is that you will still see smooth P&L, but you know at the end of it there is no money in the pot.

Hiral Desai: No, Rajeev, my question was if you are emptying the bucket at the end of the year and the flow through on the P&L for that year is only to...

Sandeep Jain: What do we mean by emptying the bucket is that the unrecognized revenue of 31st March, 2017 will rundown over its course - which is based on the loan maturities and how the income will get accrued as per EIR - it is a normal amortization. Based on this, I am just giving you an example that if you assume that Rs. 797 is entirely on account of short tenure loans that we have done of 12 months and it has got recognized but simultaneous we would have created new pool of unrecognized income as we close FY 2018 on account of new business.

Hiral Desai: I understand that but the impact through the P&L in FY 2018 is only Rs. 200 crores, right?

Sandeep Jain: Yes. So, Rs. 797 crores positive.

Hiral Desai: Sandeep, I will take it off line then. I will take it off line. So, Rajeev, the other question was on the SME target segment. If I look at last 2 years or 3 years the turnover threshold has gone down from about Rs. 25 crores to Rs. 10 crores or Rs. 12 crores right now. So, do you see this number going down further? That is first part of my question. Second is, how competitive is this space that Rs. 10 crores - Rs. 12 crores kind of turnover SMEs?

Rajeev Jain: See, the reason that number is being going down is, as we have expanded geography. So, technically, if you go outside of 100 cities, 60 cities plus this number is Rs. 5 crores - Rs. 6 crores. So, this number is not diluting the segment in Tier-I. Or. its contribution of the Tier-II market today would be 50% now. More than 15 markets is Tier-II and Tier-III will be (+60). (+60) contribution is now 40% of our SME lending book because that is really where lower leverage is, granularity is. So, that is where we are quite comfortable even a Rs. 4 crore customer doing business with.

Hiral Desai: Sorry, you said 60% is outside of Tier-I.

Sandeep Jain: 60 locations.

Hiral Desai: Okay, got it.

Rajeev Jain: So, that Rs. 10 crores to Rs. 12 crores have blended as a result. We are now doing this business in 565 locations. Competitors look this as a pure risk business and to deviate from the risk we see people at a hobby level come into the business and go away from this business because it looks on a piece of paper a higher margin business and people lose money very quickly. So, it is a pure risk business. We are on the same business at 15% - 16% growth last 7 quarters it grew 42%. So, if you correlate the to the portfolio credit quality, you do see that business from portfolio has moved back to 98.76%. Last year, same time was 98.5% and 2 years ago it was 98.69% and the way we are seeing the portfolio it could look like 98.9% current at least from a flow standpoint. So, you will just run it like a risk business rather than a growth business, if I may just use that word.

Hiral Desai: And Rajeev, on the expected credit loss how much of this is sort of objective versus subjective? Is there an element of subjectivity even in the estimation of expected credit loss?

Rajeev Jain: Yes. You have to back it with empirical data. It is much more easier in the consumer business. So, retail business is very easy to predict from millions of customers, flow rate, there is lots of empirical data, it starts to become more difficult in SME. This is virtually impossible in the commercial. I think that is really where at one level it is our view that RBI struggled with as we were engaging with them then how do you build ECL model because it has to be built on the client wise basis. Not to say it cannot be built but just subjectivity rises as you transition from retail to SME to commercial. So, there is a degree of subjectivity.

Hiral Desai: And lastly on commodity financial, you have spoken about warehouse financing in the past. So, sort of just wanted to understand because there is a thought that the entire thing could become digital over next sort of 3 years to 4 years.

Rajeev Jain: Today only one percent is Demated - very-very small. We are very slowly putting our arms around. It is an Rs. 120 crores to Rs. 130-odd crores portfolio in the business. We have invested in the last 2 years in the teams, but we still do not have the confidence to grow it. It is jeera or saunf, we are still figuring out but yes as the business gets demated, opportunity is very large. We are learning the business because I was saying it completes our rural strategy for us as a company. So, that is really the intent and the opportunity in the longer-term.

Hiral Desai: And it would be agri commodities or non-agri commodities as well?

Rajeev Jain: Right now, it is only agri commodities. As I said, it is very small it is Rs. 130 odd crore portfolio, so we are testing. That is all I would say.

Moderator: Thank you. The next question is from the line of Roshan Chutkey from ICICI Prudential. Please go ahead.

Roshan Chutkey: Just wanted to understand this. Your 89 bps of standard asset provisioning will increase or decrease based on changes in the product mix as well as it is also reflective of whether the product asset quality is worsening or improving, right? If 89 bps increases, then it is a worsening of portfolio provided the mix is the same. Is that a fair understanding?

Sandeep Jain: That is correct. It is probably correct because what may happen is that the portfolio quality may not change at all but as you see your customers season over period of time, more customers will go one and two and hence, requiring more provision.

Rajeev Jain: So, it is two: one is product mix, and another is the stability of portfolio. If stability remains exactly the way it is hypothetically, and mixes changes you will still see movement. Mix changes to favorable but stability reduce as well as you should see movement. So, welcome to IndAS, all of you.

Roshan Chutkey: And the same question that the earlier caller was asking, right you have this Rs. 797 crores of movement in the last 2 years in this subvention income that you earned, right?

Sandeep Jain: Yes.

Roshan Chutkey: Now whereas for the last 1 year, it is about Rs. 200 crores odd.

Sandeep Jain: Yes.

Roshan Chutkey: How did the 2 reconcile? So, how do I understand this?

Sandeep Jain: Rs. 797 crores, first of all, it is not only the subvention, it has processing fees as well as the cost of acquiring the business. It is a net number. It has number across businesses: consumer durable to personal loan to mortgage and so on so forth. It is accumulation of last 5 years - 6 years of business that we have done that you are seeing as Rs. 797 crores.

Rajeev Jain: I think we should repeat it because there is a question. If you go to Slide #19, you will see there the impact on account of amortization upfront fees, interest subsidy minus cost of acquisition. So, prior Hiral was also asking that is there subjectivity even in acquisition cost. There can be subjective even in acquisition cost that you may say this is directly related to customer acquisition and you may say it is not. Is a salesperson effort directly linear to acquisition done? I can argue it is, Sandeep can argue it is not. So, it leaves even in cost amortization, there is a degree of subjectivity that will emerge as a result of IndAS. I think balance sheet disclosures, will solve for it partially. But it is important we focus on it - there are 3 lines and Rs. 797 crores is not subvention alone. It is a net number. Subvention would be higher, processing fee could be higher, loan acquisition costs still be higher. So, it is a net number.

Sandeep Jain: And as the balance sheet is growing for us, this number will keep moving up unless and until we make significant movement in the portfolio mix.

Roshan Chutkey: But if can you just explain how does this compare with the FY 2018 number? So, the same number corresponding to FY 2018 will be what?

Sandeep Jain: The FY 2018 number would be Rs. 797 crores plus the full year impact of Rs. 189 crores, that will become the closing number as on 31st of March 2018. So, you have to shuffle between Slide #19 and Slide #15. Rs. 197 crores for last full year and one-time impact as of 31st of March 2017 of Rs. 797 crores put together is the balance as on 31st of March 2018.

Roshan Chutkey: Okay. And just to understand, coming to Slide #15, so this Rs. 186 crores is for the first quarter. Now you will have a similar number or maybe slightly lower number for Q3. But by the time Q3 arrives, Rs. 186 crores must have rundown?

Sandeep Jain: That is correct.

Roshan Chutkey: For the year-end, you came up with this number of Rs. 197 crores. That that our understanding is right?

Rajeev Jain: You are in a complete control of IndAS ! and if you did not grow, you will empty the bucket. So, for two quarters, you see the top-line growth is slowing down but you may not realize as the P&L growth may not slow down - two quarters down the line you may realize that. That is the point that we are going to respond to earlier respondent as well.

Moderator: Thank you. The next question is from the line of Preethi RS from UTI Mutual Fund. Please go ahead.

Preethi RS: Sir, my question is on the two-wheeler segment business. Sir, we have seen Bajaj Auto becoming aggressive in the domestic market and it is also clear from some of the comments in the annual report that competition has just started to become intense. So, how is our participation changed on let us say before and after this? Has the subvention scheme particularly has changed because our partner is aggressive it? And also, since we do not have this data point in the presentation, the financial penetration or the market share in Bajaj Auto has it increased given that we have probably 90% market share in Bajaj Auto finance sector?

Rajeev Jain: So, if we just go to the executive summary, and I will tell you that Slide #10. So, one, they are going to offer subvention, very little, they do it as a promotion play. Essentially entire money is charged from the customer that is being the construct of the business in general. In a promotion period, they may run subvention which are not material in nature. Two, if you see Slide #10, 34% of where of Bajaj Auto's domestic sales is contributed by us. This number has remained between 30% - 32% - 34% on an ongoing basis for the last I remember now 10 years or 11 years between 28% to 32% - 33% is really where I would say in the last 10 years you have seen this. Now which means, at the underlying level, if here Bajaj Auto has only moved because we are captive, we will be positively benefit from it. If Bajaj Auto numbers are not moving, then we will also see the impact. So, it is a tailwind for us as Bajaj Auto gets more aggressive, clearly reflecting as per the Automobile Association April data, May data and June data should be a tailwind for us. On three-wheeler we are 33% of Bajaj Auto's three-wheeler business. Three-wheeler is a bigger tailwind that Bajaj Auto is seeing. There is a separate two-wheeler financing business and there is a separate three-wheeler financing business and we run a reasonably efficient business to seize the tailwind. Except the two-wheeler business and actually if I correlate this to portfolio quality as the contribution of three-wheeler grows with probably at a point in time it is a smaller portfolio versus the two-wheeler we will probably strip in portfolio quality two-wheeler and three-wheeler separately at a point in time because that is causing the part of the credit quality to be yellow. I must make that point separately because if the mix changes, it changes the color three-wheeler customer is a SME or a below mass SME customer versus a two-wheeler customer or is a different customer. But we have tailwinds as a result of Bajaj Auto's growing market share.

Preethi RS: So, then it would be fair to assume that we are not taking more P&L or the balance sheet risk going forward, just because the partner is aggressive?

Rajeev Jain: I have run the company the last 11 years. It is on a pure arm's length basis. They never insist on what we should do and who we should acquire and not acquire, they have never insisted ever. So, it remains purely on arm's length basis, we take the risk. If it is at 87.6% today, we are responsible for it, not they. If it became an 85.88%, we were responsible for it and not them. So, it is on pure arm's length and we run the business that way. Lastly, its contribution to the balance sheet is now at 7%? And my view would be, my guidance would be it will probably come down to 5% - 6% ending the year not because they are not growing, they are growing but overall they are competing with 24 different lines of businesses who are growing. So, their contribution will look more like 5% which means no single business can actually impact the company that is our orientation and granularity strategy, definitely not them.

Moderator: Thank you. The next question is from the line of Bharat Shah from ASK Investments. Please go ahead.

Bharat Shah: Yes, Rajeev, no question. Hearty congratulations to you and your team. It is one thing to get growth right and the physicality of the numbers right, but it is quite nether to get the quality of the numbers right. In terms of the credit losses, in terms of the operating leverage, this year growth and maintaining the balance of all of the qualitative aspects, that is remarkable. Congratulations.

Rajeev Jain: We are committed to pursue that Bharat bhai for our investors and keep building the business out.

Moderator: Thank you. Ladies and Gentlemen, we take the last question is from the line of Nidhesh Jain from Investec. Please go ahead.

Nidhesh Jain: Sir, on the housing finance, the profitability for this quarter looks a bit muted, any reason for that? That is the first question. Second question on the fee income, what quantum of the fee you have originated from life insurance? And how has been the growth on a Y-o-Y basis in that line item? And lastly, on the ECL, which product line has the maximum impact on ECL? And which product line has the least impact on your ECL numbers?

Rajeev Jain: Look, I will start with BHFL I am just looking for the results. So, look we did not do detail results? So, fundamentally, you have to look at it in this way that their GP itself was Rs. 6 crores. They are building out the business, there are no other assets there out of Rs. 7,272 crores of assets. Mortgage is an AR business/AUM business in the year or the month in which you acquire or the quarter that you acquire, you are actually are investing that entire money mostly on the general provision. So, GP, pre-GP is really the way to look at it because especially within that the LGD will be really-really low as we move ahead. It is a young business you will see very similar numbers play out on a standalone BHFL for two maybe for the current year is what I would say from next year onwards you start to see some profitability emerge. As I was telling investors or shareholders in the AGM as well that these are all incubations, please be patient as they are going out and building a rightful model and building the business out. Your second question was on insurance. We work with 9 insurance companies across life insurance, general insurance, health insurance originates a lot of insurance across life, general, and health run our insurance income on an arm's length basis that we publish for that they offer to all their partners. What number it is, is a bilateral conversation between us and the insurance distributor. But our captive play is less than 35% - 40%, rest 60% is across non-captive and it is all based on arm's length. Third, you had a question on ECL?

Nidhesh Jain: Which product has maximum impact?

Rajeev Jain: Which product has maximum impact, which has the least impact? Loans against security is the least impact, right?

Sandeep Jain: Commercial balance sheet. Commercial balance sheet including loan against securities because empirically we have not seen any losses in that has seen significant reduction in the standard assets provisioning whereas other parts of businesses we may see some level of increase.

Rajeev Jain: So, going back to the point that you were making earlier, the two-wheeler, if you see this business you have to start to correlate the conversation with the portfolio quality data that we share because this is now not about 90 days. So, in a way two-wheeler, three-wheeler portfolio would have a disproportionately higher share of provisioning that has come into the number because they are 12%, 30 plus is 6%. So, it is technically Stage 2. So, that is how you will have to start to read Slide #26, #27, #28 to the earlier question, even Nischint was asking that these numbers move, loan loss provision will start to move. These numbers drop, empirically the loan loss provisions will start to drop. They will start to correlate much more closely to P&L. Otherwise, it need not play into P&L the way things are organized today. We want to run the business parts of it if I give you example, and that is why we saw no impact of transition from 180 to 150 to 120 to 90 because in many of our business that 60 days past due we charge off 70%. So, it is flowing through. Otherwise, the impact on such a large balance sheet of ECL could have been still higher. I must make that point importantly, whatever small, large, less than Rs. 200 odd crore number on a Rs. 94,000 crore balance sheet. So, the P&L was fully costed, now even the balance sheet is fully costed. So, that is really how we would articulate.

Nidhesh Jain: Sure. Just to one more question on housing finance, given the interest rate scenario on the liabilities side and competition on the asset side, is there any change in strategy in that business? And secondly, what percentage of your disbursement comes from balance transfer from an existing lender?

Rajeev Jain: Around 50% comes from balance transfer. I would rearticulate they are a baby off the ground, wait for the baby to walk. We will stay focus on mass affluent customer, no affordable housing, we are now doing business in only 45 cities in India. It is an AAA rated business, which means it allows us to target an AAA for a client. As a result of BHFL transition, our overall cost of funds for the mortgage business has dropped because the bond market prices NBFC separately and HFC separately. Apple-for-apple, same day the BFL goes into the market, we see borrowing cost goes for Rs. 100 crores bond market borrowing for an NCD, if we get ‘x’ coupon rate, we get 15 to 20 basis points lower coupon rate which means it is beneficial to transition this business and run it as part of HFC. So, net-net, we are quite excited but yes, we have to be patient.

Moderator: Ladies and Gentlemen, that was the last question. I would now hand the conference over to Mr. Karan Singh for closing comments.

Karan Singh: On behalf of JM Financial, I would like to thank Mr. Rajeev Jain and the senior management team of Bajaj Finance and all the participants for joining us on the call today. Thank you, and goodbye.

Rajeev Jain: Thank you.

Sandeep Jain: Thank you all. Thank you.

Moderator: Thank you very much, sir. Ladies and Gentlemen, on behalf of JM Financial, that concludes this conference. Thank you for joining us and you may now disconnect your lines.