L&T Finance Holdings LImited

Analyst Conference Call Transcript
January 21, 2015

Moderator: Good evening and welcome to L&T Finance Holdings' Q3 FY15 earnings conference call. We have with us on the call Mr. N Sivaraman – President and Whole-Time Director and other members of the senior management team. We will initiate the call with opening remarks by Mr. Sivaraman followed by an interactive Q&A session.

Kindly note that the statements made in today's call would be forward looking in nature and a note to that effect is stated in the presentation sent to you earlier.

I would now like to request Mr. Sivaraman to provide us his views on the results for the third quarter. Thank you.

N. Sivaraman: Good evening and thank you for joining the call. I hope all of you have got the copy of the presentation, which is also available on our website. We start with slide #3 – "Highlights of LTFH performance":

We have had a good year on year growth of 20% in loan assets which is now at Rs 45,225 crores, while the loan asset growth is slightly subdued at 13% when compared to the FY14 number of Rs 40,080 crores. This is a function of the current economic environment which has resulted in limited opportunities in terms of sectors as well as quality opportunities within sectors that we would like to finance.

The disbursement growth has been strong during the 9 month period. We have had a 32% growth on a year on year basis. Disbursement have been to operational projects in the infrastructure segment - renewable power as well as roads. We have also made a new beginning in underwriting and sell down of bonds. This business helps in using the available net worth to generate fee income on our balance sheet. Our B2C product segments have also shown a good growth. The lines of businesses where we have grown are by choice, where we have chosen to improve disbursements and increase our market share. There are segments where we have made a very clear choice of not pursuing disbursements aggressively. For the quarter the disbursement growth has been about 46% on a year on year basis, largely contributed by the wholesale lending business.

The profits have grown quite well, our profit growth for the quarter has been 66% on a year on year basis. Yes to a large extent this improvement has been contributed by significant amount of credit provision that we took in Q3 last year as compared to what had been done in the previous few quarters of the last year. The profit contribution has come from very steady NIMs - handsome margins in the retail business contributed by both consistent improvement in pricing of assets as well as an effective liability management strategy. Liability management has been a focus area given the way the markets have moved on interest rates and this has helped us bring down the cost of borrowing as well. Fee income has been good in both the businesses, as I mentioned both by way of underwriting facilities for operational projects as well as for bond issuances. Some of the large ticket transactions which we were able to complete in the retail segment have also contributed to the fee income. The disbursements in the B2C segment also earned us a healthy subvention income. Operating expenses have remained stable between the two quarters while it might have gone up as compared to the previous quarter of last year. This increase is mainly on account of our focus on the B2C businesses which involves more manpower as well as reach.

Asset quality has shown stability between the two quarters and we do believe that Q4 will see this trend continuing. We have had a spike in the NPAs in the retail business mainly on account of the tractor segment, that too in specific states and is seasonal. Our belief is that by Q4 we should be able to bring down these NPAs. The heartening piece in our performance has also been the provision coverage that has gone up from 33% in Q2 to 35%. If one compares this to the end of the last year i.e. FY14 we were at about 28% provision coverage. Looking at the corresponding gross NPA numbers, this translates to about Rs. 95 crores of additional provisioning that we have made on our books and that has been factored into our performance. In addition to this we have also taken a provision based on the valuation of some of the SRs on voluntary basis. If we factor in all of this our overall provision coverage against stressed asset segment has gone up significantly.

The next slide talks about the summary financial performance in numbers for the nine month period - loan growth of 20%, disbursement growth of 32% and NIM growth of 28%. I would like you to note that as compared to average loans and advances growth of roughly 20%, we have a NIM growth of 28%. Earnings before credit cost has consequently gone up by 30%, a result of NIM increase as well as stable operating expenses. While there has not been any significant deterioration in the overall asset quality, credit costs have gone up as a result of our conscious decision to increase the provision coverage. We believe this increase in the provision coverage will help us leverage better in the ensuing year and as lending opportunities come up we should be able to meet most of our capital requirements through leverage. We can perhaps take some more time before we raise fresh equity capital for all our businesses. PAT growth is at 19% on a year-on-year basis for the lending businesses. Gross NPAs have remained more or less stable while the absolute quantum has gone up marginally due to the factors mentioned earlier. ROEs have remained stable across quarters but if you look at it on a year-on-year basis there is a smart improvement and when compared to the year as a whole as well we are looking to see some improvement coming through.

On the investment management business - the good news is that we have seen robust equity sales that have resulted in the proportion of equity assets as a percentage of the total assets jumping to 35%. This is definitely a notch above the industry average. PAT before amortization is Rs 2.4 crores, partially contributed by some one-off items. But the important aspect is that despite very good gross sales in the equity schemes and absorbing some of the upfront payments, we are still having a break even situation. This shows the revenue potential of the business.

The next page slide #5 gives you details about the PAT contribution from the various business segments. Retail has grown by about 30% compared to last year while wholesale has remained flat for the nine month period as compared to the last year, largely due to the provision coverage that we have attempted to achieve in this segment. Other segments which used to be a bit of a drag in the past few years have really turned around and they are looking more closer to break even than earlier. So the PAT before exceptional items on a consolidated basis has grown by 29% year on year for the nine month period. For the quarter it is about 66% growth on a year on year basis, which is again a very healthy number given the environment that we are facing.

The net worth committed to various businesses is as given in the table in the bottom half of the slide. We have increased the preference capital to about Rs. 1,363 crores. Our EPS (non-annualized) for the nine month period after adjusting for preference dividend has gone up by about 26% from Rs. 2.07 to Rs 2.60. This basically reflects the underlying improvement in the operating performance of all the businesses.

I would now hand over to Dinanath Dubhashi who heads the retail finance business.

Dinanath Dubhashi: Good evening everybody, moving to the next slide #7 which is on each market that we are in. As you know none of the markets are actually showing an extremely good performance as far as growth is concerned. My focus here will be to explain our strategy in each of the markets and how we are managing to grow in some of our chosen segments in spite of fairly large de-growth in some of the markets.

So as you are all aware the tractor markets after seeing 20% plus growth in the last 2 years has seen a significant drop this year and is expected to continue that way. Some of the industry studies indicate a 4% to 5% drop, but we actually expect the drop to be higher. This has been contributed one, by fairly large growth in the last 2 to 3 years and two due to the sub optimum distribution of monsoons, even though monsoon caught up fairly well after the initial delay. Despite this we have grown at a healthy pace in the tractor market, our market share grew from just about 9% to more than 12%. The strategy we have followed as mentioned last time was to tie up with some of the strong tractor manufacturers in the industry and grow together by sharing our resources for sourcing, collections and trying to identify the good customers in the market. Our tie up with International Tractors i.e. the Sonalika brand is working very well and resulting in good growth for both the companies. We are in a similar kind of tie up with Escort Tractors as well. Similarly in two-wheelers, the market is just about flat as of now though the scooter segment continues to grow better. Here too our network and hold on the market coupled with our excellent tie up with Honda which is gaining market share has enabled us to gain market share. So these two segments continue to grow for us in vehicle finance. Another market where we are doing very well is microfinance. We have been growing this business from FY12 and now we are in 8 states. We have entered two new states this quarter and we are growing there at a fairly good rate

As for the car segment, as you all know even though this quarter we are seeing some growth, it has not looked too well and the LTV ratios in the market have also increased. We anyways have a small share and we have substantially reduced our disbursements because we are not seeing a good risk return paradigm in this market. Construction equipment continues to be negative for the 4th straight year while commercial vehicle is just seeing some early signs of pickup. But we should all remember that these early signs of pickup are as compared to minus 30% kind of de-growth in the last 3 years. So we will continue to wait and watch in these segments.

On the mid-market i.e. the corporate business in the retail and mid-market portfolio we continue to look at good deals, deals which are structured tightly, tied up for security as well as structured for cash flows and these will continue to be on an opportunistic basis. Our SME business i.e. dealer and vendor financing continues to show decent growth and we have grown at around 11% there. As we get into new tie ups with manufacturers we will have a steady growth in this segment.

The next slide #8 puts all of this into numbers. So the overall rural product finance disbursements have grown around 7% in the nine month period and within this tractors have grown by a little over 14%. Though personal vehicle finance shows a negative 2% growth in disbursements, it has seen good growth in two-wheelers and de-growth in cars. Microfinance had a 91% growth on a smaller base of about Rs 400 crores. We have grown due to expansion of areas where we are doing business and also due to the strong business model that we have put in place to support this growth. The remaining segments are in line with what I have mentioned earlier. The overall disbursement growth is flat, but if you adjust for construction equipment and commercial vehicles where we are practically out of the market, the rest of the disbursements have grown at around 6%.

The loans and advances book has grown at around 5% and is more or less in line with the disbursement growth. Rural product finance book has grown by 30%, microfinance book has doubled, supply chain finance has shown good growth of 42% and there is a big de-growth in construction equipment and commercial vehicles. So while growth in overall disbursements as well as loan assets has been muted, but if we adjust for commercial vehicles and construction equipment where we have stayed away, we have had a decent growth in the given environment.

Moving to slide #9 on summary financials - against the book growth of 5%, the interest income has grown by 17% and NIMs have grown by around 31%. This has been due to the portfolio shifting to B2C and thus giving us higher NIMs and also treasury reducing the cost of borrowing. Some of the interest rate cuts in the economy have translated to our balance sheet even before the policy rate cuts due to few aggressive market borrowings that we made, thereby shifting our borrowing portfolio from banks to the markets. Additionally there have been a couple of large NIM deals in the corporate book which would contribute around 20 basis points in the NIMs for this quarter. All of this has led to a 31% growth in NIMs for the nine month period. Fee income has shown a handsome growth. The tie up with strong manufacturers has resulted in good subvention income as well as savings in acquisition costs. This along with some large deals in the mid-corporate segment has led to a jump in fee income.

Operating expenses - though they have grown by 25% you have to take into account the shift in portfolio towards low ticket high NIM products and our analysis shows that a basis point increase in operating expense is only a fraction of the basis point increase in NIMs. Earnings before credit cost are up by 39% while credit costs are also up by 39% because of two reasons - one as Mr. Sivaraman said we have seen a seasonal increase in farm NPAs in certain parts of the country. We believe that the rabi crop is quite decent. We hope and I am pretty confident that this increase is only seasonal. Second, we have continued on our endeavor to increase the provision coverage. Just over the last 6 months we have increased the provision coverage from about 35% to 43% at the end of the quarter in the retail business. So accounting for all this we see a year on year growth of around 30% in PAT. Even when we take trailing 12-months vis-à-vis last year the PAT has grown by around 20% on a more or less flat book. This is an indicator of efforts that the company has put in terms of focus on NIMs and cost control as well as trying and controlling credit cost while at the same time increasing coverage to make the balance sheet stronger. The gross NPAs have increased by about 16% due to reasons I have already explained, but the net NPAs has grown by only 2% due to the increase in provision coverage that we have undertaken.

The next slide #10 discusses ratios which more or less in line with what I have explained. In Q3 the NIMs are 7.79%. Adjusting for some one-off transactions, we would guide a sustainable NIM to be around 7.25% to 7.35%. To achieve growth we might have to pass on some of the gains to the customers and also since there was hardly any growth, gearing of this business has actually reduced and as we increase gearing again the NIMs will definitely fall a little bit. So the increase in NIMs from 6.3% in FY14 to TTM NIM of 7.22% is definitely sustainable, but this quarter NIM of 7.8% would moderate going ahead. Operating expenses remain at around 3% level and credit costs are at 2.44%. I have already explained that part of it is seasonal and the remaining is our endeavor to increase provision coverage. Return on assets has continuously risen to about 1.8% in this quarter and the ROE is about 12.48%. If you track the last eight quarters, the RoE has continuously risen quarter on quarter from around 8.5% to about 12.5% now. So clearly this has been in line with the guidance given earlier of a steady improvement in RoE as credit costs on the corporate portfolio begin to taper and the incremental portfolio grows as per the strategy explained earlier. The CRAR is close to 18% which actually shows that we have enough scope to grow without really increasing the Tier-1 capital. Hence whatever gains we make will directly flow into the return to equity shareholders.

The next slide #11 - I will talk briefly about the housing finance business. It is a new business, just about 2 years old. Our focus is on setting up the business and moving towards steady state ROE. The traction has been good in this quarter. We achieved disbursements of around Rs. 600 crores. We are looking at continuously increasing this on a steady state basis. It suffices to say that right now this business is going well according to the business plan that we had in mind at the time of setting up this business. The growth has also enabled us to take the gearing levels to where housing finance businesses operate i.e. to around 8.0 - 8.5 levels. With this I will hand over to my colleague Mr. G. Krishnamurthy for taking you through the wholesale finance business.

G. Krishnamurthy: Thank you Mr. Dubhashi and good evening everybody. In slide #12 we will run through the market scenario and outlook:

In thermal power as you all know the government is doing a lot of things to improve the outlook. Essentially we expect coal auctions to happen this quarter and as a result of that additional investment in mines and improvement of coal supply to power projects should happen over the course of this year. So we do expect improvement in performance of some of the operational projects as well as recommencement of some of the stalled projects towards the end of the year. Having said that I don't think we expect any green field financing in the whole of the current year as such. We will be taking exposure selectively in operational projects where last mile funding is required. One more area where work is yet to be done is regarding the state of finances of the discoms where some more reforms are required.

Renewable energy is a sweet spot for us. We are market leaders in this, both in wind and solar and to an extent in hydro and this also is an area where the government is putting lot of focus to expand the capacities. In fact in solar while the current installed base is about 3000 MW, we expect a year on year growth with installations of 3000 MW in this sector. This means that the scaling up of the sector is going to be much faster and we are gearing ourselves to meet the increased demand from our customers in this sector. We have a good market share and we have a good relationship with all the top 10 IPPs in this sector and we expect this sector to drive our growth going forward also.

Roads - there have been EPC awards and we see increasing momentum in EPC while BOT projects are going to really improve after a quarter or so. We will be predominantly focusing on operational road financing, thanks to our IDF where we have an advantage and where we are very competitive.

Regarding the other sectors, couple of areas one is of course telecom. When the auctions get completed we will have more clarity. We could look at some financing deals on opportunistic basis here with improvement in the financials of this sector. We continue to take exposures to LRDs as we expect the commercial real estate sector to stabilize and grow further.

One more thing we see is that the EPC sector, where the revival is important for us particularly because some of our restructured assets are in this sector. It is going to take a slightly longer time given the pace of execution at the ground level and results will be expected in the next 2 to 3 quarters during which we will have to keep a close watch on our restructured assets.

Moving to the next slide #13 - we had substantial disbursements in this quarter ~ Rs. 4,160 crores and close to 30% of it were from the renewable sector which is our core strength area. Another substantial area, which is classified as “Others” today comprises of 2-3 segments - one is we had a disbursal of about Rs. 600 crores for bonds, essentially project bonds as well as PERPs of the banking system. We also had about Rs. 600 crores of short term disbursements which we have made to the non-infra sector. So what it also means is that some of these disbursements will be sold down in Q4 and so Q4 asset growth will be slightly different vis-à-vis what we have seen in Q3. In fact if you see the loans and advances our total growth has been 30% year on year. In the last one quarter that is Q2 to Q3 itself we have shown a couple of Rs. 1000 crores of increase in assets. Based on this expected sell down of about Rs. 1000 crores and based on repayments of about Rs. 600 crores of the short term loans as well as unwinding of some part of the bond book we expect asset growth to be slightly more muted in Q4.

At overall levels our operating assets have increased to 46% which is a substantial increase from 32% a year ago. At a book level a strong growth has been shown as the renewable book has grown by 58% to Rs. 4,865 crores and this will continue to be a driver for us in the future also. And the second sector where there is a large growth is transportation where again we have been doing operational road projects along with our infrastructure debt fund. So these two segments will continue to be strong drivers of growth for us.

Moving to the next slide #14 - while our gross loans and advances have grown by 30% on a year on year basis, some of these disbursements have been lumpy and they have been towards the end of the quarter. So the average assets have grown by about 23% which is the bench mark against which we need to compare all the P&L numbers. Based on the 23% average asset growth we have an interest income increase of about 18%. Two reasons for this – one is that our GNPAs went up to as high as Rs. 608 crores in Q1 and subsequently it has come down to Rs. 484 crores. Since we don’t accrue interest on our NPAs there is reduction in interest income. There is also a 20 bps reduction in our gross yields on the standard asset book to the extent that we are doing finer priced and better quality deals. So interest income has grown by 18% on a year on year basis compared to 9 months of the last year. Interest expense has grown at 21%, here we have two things – our debt to equity has increased and we also have some savings in our WACC because we have been increasing our bond book and reducing the proportion of our bank borrowings which has enabled us to optimize our cost structure.

Fee income is something which is notable, in Q3 itself we had Rs. 34 crores of fee income vis-à-vis Rs. 36 crores in the whole of last year. What essentially is happening is that we are underwriting a lot of projects both in renewables as well as road re-financing and this is leading to good underwriting income and which is fairly sustainable. We expect, maybe not at Rs 34 crores level per quarter but definitely a good growth in the next few quarters in the fee income based on our underwriting capability. Other income for 9-months has been Rs. 20 crores vis-à-vis Rs. 56 crores for last year. We had capital gains of Rs. 21 crores from sale of equity assets to the private equity fund last year, which is not there and that is the reason why this is lower this year. Other income is primarily our returns on liquid investments that we have in our books. Operating expenses at Rs. 81 crores is virtually at par with Rs. 75 crores if we consider CSR expenses which have got added as a line item this year. We have maintained operating expenses at the same number as last year but for this. Credit cost has grown 27% to Rs. 210 crores for the 9 months. Two major reasons, one is voluntary provisions and the other is that we have made provisions against some of the securities receipts (SRs). In fact today we are carrying SRs at about 40% of the original book valued assets, so we have been adding provisions against our security receipts also. A mix of additional provisions, security receipts related provisions and the impact of one time income of Rs. 21 crores in the last year; our PAT growth has been flat for 9 months at 2% at Rs. 259 crores.

GNPA had achieved a peak of about Rs. 608 crores in Q1 and after that it has come down both in amount as well as a percentage, and today we are at 2.3% of GNPA and NNPA is at 1.7%. Our provision over RBI norms stands at Rs. 81 crores.

Moving on to the next slide #15 – the ratios broadly mirror what we discussed in the previous slide, except of course yields and cost of funds where because of the bunching of deals, large disbursements which happened at various points of time and large pre-payments, there is a volatility. So having said that I think NIM will stabilize at these levels moving forward at about 4% and that is something which is going to be on a steady state basis. NIM at 4% and fee income at 0.4% is something which is going to be sustainable. Operating expenses are also going to continue to be at the same level for the next quarter. Credit cost for Q4 is going to remain stable to downwards, but we need to watch our restructured assets over the first half of next year. We will maintain a close monitoring on the up gradation or down gradation of the restructured assets in the next couple of quarters of next year. RoE for 9 months has been at 11% lower than 12.69% for the same period last year. Gearing has increased to 6.09 from 4.85 and CRAR is at 16.26%. We will continue to raise Tier-2 as we move forward to improve our CRAR but also to ensure that our leveraging increases. With that I would like to hand over to Ms. Ashu Suyash.

Ashu Suyash: Thank you Mr. Krishnamurthy, good evening everyone. I am on slide #16 - the investment management industry has had a good year, largely driven by positive investor sentiment and better allocation to equity, something that we are seeing almost after a gap of three to four years. On the back of that, industry assets increased by 4% from Rs. 10,60,000 crores to about Rs. 11 lakh crores. The increase in equity was largely driven by market movement but some amount in net sales as well, almost about Rs. 22,000 crores of net sales were added at an industry level. Fixed income flows were largely muted with FMPs seeing outflows, marginal improvement in money market although towards the back end of the quarter with rate cut expectations, bond funds started seeing inflows. From our perspective, in Q4 our strategy would really be to gain market share in the fixed income space through a new fund launch - Resurgent India bond fund, which is a duration and accrual strategy fund, to continue building on our equity flows. We have had a good run this year, in fact our equity mix as Mr. Sivaraman pointed out improved to 35% from 28%, when you look at a 9 month kind of a period. This is really built on the back of strong fund performance. We have more than 75% of our fund range in the top two quartiles and several in the top quartile as well and also our efforts in hosting investor education events and seminars in the small as well as medium-sized cities. We continue to maintain a very tight control on expenses and are careful around our marketing spend. Key risk to this business is always any regulatory announcements as well as significant market movements led by either global events or domestic events.

Moving to slide #17 and talking specifically about the business -our coverage continues to improve and we cover 500 districts today and have over 8 lakh accounts with branches only in about a little over 50 cities. Talking about revenue growth – Q3 over Q2 saw our operating revenue grow to 34 crores from 31 crores. On a year-on-year basis the growth is 38% with the 9-month FY15 revenue being Rs. 89.4 crores versus Rs. 64.7 crores in the same period last year. This is driven by a larger share in equity and clearly equity is the higher yielding product from an investment management point of view. From a year on year basis operating expenses show a 34% increase while Q3 to Q2 is largely flat. The increase is largely on sales and distribution expenses directly linked to our growth in equity assets which you can see from the chart below. We have grown equity assets by 57% on a year-on-year basis. We were about Rs. 4,700 crores, and have now grown to nearly Rs. 7,500 crores in equity assets. Overall assets grew by 25% to Rs. 21,300 crores from Rs. 17,000 crores. The product mix has resulted in better management fee to AUM ratio, increasing to 0.62% versus 0.59% in previous quarter and 0.54% a year ago.

Moving to slide #18 to touch upon wealth management – the business continues to grow steadily on the back of client acquisition. Our client base increased to 2,700 clients from 1,600 clients. There has been a 25% growth year on year in assets, Rs. 6,200 crores versus around Rs. 5,000 crores last year. Our focus is client acquisition and looking at customized solutions to family office type customers, high net worth individuals and the mass affluent market. We will build our presence in the Dubai market and grow our real estate advisory business while continuing to add equity and alternate assets from the overall assets under advise perspective. With that I hand back to Mr. Sivaraman.

N. Sivaraman: I hope the presentation has been useful and you have got all the inputs. You may now ask questions. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session**.** We have the first question from the line of Sameer Bhise from IDFC. Please go ahead.

Sameer Bhise: A couple of things primarily on the retail and mid-market finance business - on the tractor side, we are seeing healthy growth in terms of loan book, but as you indicated there has been some stress that you have observed in the quarter, so what is the strategy going forward? Will loan growth continue to be around the same pace or are you looking at some slowdown because even on a QoQ basis disbursements have grown at a reasonably robust pace.

N. Sivaraman: I think given the timing and spread of the monsoon and also that our market share has really gone up over the last four to five years, we have been extremely choosy and we have been looking at a safer strategy to enhance our presence in this segment. That is why as part of the presentation Dinanath did mention about manufacturer tie ups as the key way to grow business volumes. The manufacturer tie ups do cover end to end sharing of efforts as well as cost. Consequently we have been able grow on a disproportionate basis with a level of safety as compared to most other financiers in this segment. As regards the spike in the NPAs, I will request Dinanath to supplement what I have told you.

Dinanath Dubhashi: I think Mr. Sivaraman has covered the question of growth very clearly, so definitely the market has de-grown, more or less expected given the monsoon and also seeing that the industry has grown quite well for the last two to three years. Now the strategic choice was to go with the market and de-grow, but actually good management action will be to see where the growth can come from and hence we tied up with the manufacturers. This not only helped in increasing market share but also helps us in sourcing good customers. The manufacturers that we have tied up with have extremely good presence on the ground and it helps us source good customers and also help us in collections. We are very clearly seeing differential performance of the portfolio vis-à-vis the overall portfolio. So that covers the growth strategy.

As far as the increase in NPAs is concerned, there have been certain areas especially in Central India where there has been a complete failure of the soya crop. Zero monsoons in June resulted in the losses in sowing. Each sowing costs close to Rs. 5,000-6,000 per acre and the farmers had to take that cost. This led to farmers with intentions to repay, actually not having the capacity to repay for this period. What we are seeing now is increasing shift to paddy from soya and also a decent winter rain in the same area, which leads to the hope that the wheat crop will be a good crop. We are seeing those early indications and hence we hope that asset quality will come back to normal levels and this increase will be largely seasonal. So that is as far as the asset quality is concerned. I would not specifically like to give you a guidance on how the growth will be, because yes it will be largely dependent on the industry but our strategy of tying up with a couple of manufacturers and hence sharing knowledge, manpower and costs will continue.

Sameer Bhise: I believe we have continued to grow despite industry shrinking, what would be our approximate market share as of now for the tractor business?

Dinanath Dubhashi: We will be at around 12.5%.

Sameer Bhise: 12.5%, this is on loans outstanding?

Dinanath Dubhashi: It is not on loan outstanding, it is on disbursements.

Sameer Bhise: Disbursements, yes**.** Secondly when I look at the BSE Release it indicates allowances and write-offs of around Rs. 179 crores, while we look at the presentation credit costs are around Rs. 226 crores for the quarter, the difference would be standard asset provisioning, I believe.

N. Sivaraman: No, this is the way we want to actually represent the credit costs. Any interest reversals on the NPAs which arise during the quarter are grossed up as part of the credit cost in our analyst presentation. The reason is that we can manage the margin volatility, which can be explained better and the credit cost would truly reflect the cost of such slippages.

Dinanath Dubhashi: So analysts come to know the actual margins that we have and then whatever we reverse is added to the credit cost.

Moderator: We have the next question from the line of Devam Modi from Equirus Securities Private Limited. Please go ahead.

Devam Modi: The first question, you mentioned on the retail front regarding your steady state NIMs and operating expenses. If you could just give some highlights on what kind of credit cost and leverage we are targeting to reach, because we are already at a slightly high level over there. So what would be the target be?

N. Sivaraman: If one takes the leverage at the current level the steady state in NIMs should be in the region of about 7.3% to 7.5%. Credit cost historically we have been at about below 1%. Given the expansion of the retail book I would expect we should be somewhere in the range of around 1%. It is not going to be as high as it is today. If your question is around the ROE**,** definitely from 2.44% there is a good scope for reduction of the credit cost which would help our ROE.

Devam Modi: So you are saying the leverage will really be a function of the environment at that point of time

N. Sivaraman: Leverage will be a function of environment here plus the health of the balance sheet. The health of the balance sheet reflected in the form of provision coverage as well as net NPA to net worth is a clear indicator. The strategy that we have used during the current year has been to improve the provision coverage so that when the market picks up next year we can enhance the level of leverage.

Devam Modi: And what kind of provision coverage would we be targeting?

N. Sivaraman: Retail we have said that it should be in the region of 50%. If you look at the current numbers, 43% provision coverage ratio plus if I factor in the assets in hand, we are pretty much close to 50%. With the outlook that we would see stable to reducing NPAs in the retail segment, provision coverage should not cost us too much on the P&L. If you look at the wholesale segment, our target is to take it to around 30% to 35%. As I have said at the time of the opening remarks, clearly we have got two classes of assets which we need to really look at in the wholesale business - one is the NPAs on the books and the other is the security receipts. This quarter we chose to enhance the level of provisions against security receipts held in lieu of assets sold to ARC. This is a balance that we will keep doing depending on how the valuations are from independent agencies for the security receipts. The target of achieving 30% to 35% will be calibrated in a manner over the next two to three quarters.

Devam Modi: In this quarter has there been any incremental sale to ARC in either wholesale or the retail and mid-market business?

N. Sivaraman: Retail does not sell assets to ARC while in wholesale nothing has been sold.

Devam Modi: Also on the wholesale side especially with regards to the restructured book, would what be the general security cover on those assets? How tightly are those assets secured?

N. Sivaraman: Typically it is a consortium lending for all these assets. So it will be the entire balance sheet which will be pledged to the lenders. So there is always a pari-passu charge when you end up participating in a CDR. What I will say is that for all the companies which are in the restructured book, we do believe they have the basic organization intact. The delay in the economic pickup as well as the flow of orders to these entities have had an impact on their cash flows as compared to the time when all the institutions made the assessment to provide a restructuring opportunity to these entities. So it is a question of the time of revival for these entities. This is what we believe will be the true way to understand the assets under restructuring as of now as far as the construction segment is concerned.

Devam Modi: You mentioned about increasing green field activity from NHAI in some states. So would new road projects be a significant part of these companies revival.

N. Sivaraman: Absolutely, all the construction companies do have a significant portion of road related activities, so that will be an important fillip to the way they behave on the ground.

Moderator: We have the next question from the line of Nishchint Chawathe from Kotak Securities. Please go ahead.

Nishchint: The first couple of questions on the retail business - just wanted to understand your conviction on the rural business. Is it more because of the manufacturing tie ups and the sharing of efforts and cost or is it more in terms of saying that from now on, possibly we have seen the worst?

N. Sivaraman: See the contribution of the rural business to the GDP is fairly significant, right. There is both consumption and investment demand coming in from the rural segment. Perhaps one can say that till such time the banks really complete their rollout of network, which could be some time off, they continue to present extremely strong opportunities for NBFCs like us. One is because we have the reach, second, because we also have the nimbleness to be able to respond to them. So there is a basic conviction. On which product to do and at what point of time in this market is a function of what the opportunity is and what are the results associated with that. What we explained as far as the tractor segment was concerned is about the way we approached our penetration. As I mentioned earlier we increased the penetration in this market with appropriate manufacturer support, both in terms of effort and also in terms of cost. So we do believe that there is no reason to really shy away from the rural market. It is going to be a function of income level in the rural market. To some extent consumption in this segment was impacted in the last year both on account of monsoon as well as the reduced transfer from MNERGA. But I suppose with the welfare program being rolled out and also some of the direct transfer benefits coming through, the income transfer into the rural segment will go up. I am sure that we all understand why the government has not really revised the minimum support price for the produce. They do need to manage inflation. So once the inflation in food products, especially in cereals, vegetables, fruits and oil seeds do come down I think the government will have the flexibility to look at the minimum support price more liberally than what they have done in the past. So, I think we will continue to remain engaged and interested in the rural segment significantly.

Dinanath Dubhashi: Absolutely and in fact the manufacturer tie up is neither a conviction nor a strategy, actually it is just a tactic. It is a manifestation of the nimbleness that Mr. Sivaraman talked about. So how to manage a situation in which the market is going down, that is a tactic. Tomorrow if the situation changes the tactic will change.

Nishchint: Do you have a similar kind of an arrangement on the two-wheeler side as well?

Dinanath Dubhashi: That is correct, not the same, not all terms are same, but yes, in principle similar with Honda.

Nishchint: Is it possible for you to share data on segment wise yields and NPLs in this business?

N. Sivaraman: I think that will get little too granular, all that we can tell you is that there is always a margin with reference to the operating cost and the risks underlying in this segment that is always taken into account. But if you look at the overall NPL, definitely we are at the bottom zone as far as the overall industries comparable are concerned.

Nishchint: If you permit, maybe I can kind of get this a little differently, if you try to segment the ROEs in each of these segments, in which of these segments would the ROEs be better than the overall average ROE of this business and where would it be higher and where would it be lower in FY15?

N. Sivaraman: The segments which do contribute to stability in the asset book as well as the collection efficiencies would typically attract lower ROE goals from our end because it does help the overall credit rating of the entity. So it will be the corporate segment which typically will be targeted towards SMEs, where the collection efficiencies are far higher and hence will definitely take a lower ROE goal. On the other hand microfinance has got its own risk even though the situation on the ground is 99.9% collection efficiencies. The underlying risk in this segment is far higher though we do charge them more as the services cost is quite high. The commercial vehicle and construction equipment segment again depending on whether the person is an individual or a fleet operator the rates will be different. Similarly if you look at the tractors, the LTVs as well as geography, makes a difference to the way we target ROE. So even if I give you one product at certain level, it may not apply to every transaction that we do.

Moderator: Thank you. The next question is from the line of Sumit Shikhar from Edelweiss. Please go ahead.

Sumit Shikhar: My question is pertinent to personal vehicle finance. Correct me if I am wrong, it would consist broadly of two wheeler and car segments?

Dinanath Dubhashi: That is correct.

Sumit Shikhar: If I heard it correctly you said that the two wheeler segment has been quite flat while the car segment has gone down. Can you roughly give us an estimate of this in your AUM of about Rs. 2,800 crores, what would be the contribution of two wheelers? Secondly how have you seen this sector evolve or work out for you after your recent tie up with Honda?

Dinanath Dubhashi: Out of the total personal vehicle finance portfolio around 50% of the AUM is two wheelers while in terms of disbursement a little more than two thirds is two wheelers. You would also understand that given that it is a 2 year product generally, a small part of the disbursement actually sticks to the book where as a car product is three to five years disbursements tend to remain part of the book for longer duration. The two products in that way have different yields and tenors. Growth will also be a function of our market share. While in two wheelers we have a fairly significant position with around 7% or so in cars we are marginal player. Hence in a market like this it makes more sense to concentrate on products that we are strong in and hence the tie up with Honda. As you are aware Honda is increasing its market share, this continues month-on-month and it makes sense to tie up with them given that they are a very strong player. That does not mean we don’t tie up with others. We have an equally good market share in Hero as well as Suzuki or TVS. But Honda is the main growth engine.

Sumit Shikhar: So it can be assumed that this is what is going to drive your personal vehicle segment?

N. Sivaraman: Yes in the near term. You never know when the car segment turns around, and then it will be a different story. But yes, in the near term this is what it is.

Moderator: The next question is from the line of Devam Modi from Equirus Securities Private Limited. Please go ahead.

Devam Modi: Just a repeat question on especially this Honda and International Tractor tie ups. Are there any stringent qualification requirements or something like that or they will basically tie up with any large lender?

Dinanath Dubhashi: It is not an exclusive tie up on both ends. However, everything does not have to be legally tied up, right. I mean, every relationship and every tie up has to give win-win. As long as both of us see a win-win relationship there may not be requirement of going around looking for more tie ups. Of course there is an element of spreading of risks, which I think both of us will do, but suffice to say at this point of time both of us see a lot of value from the relationship. As you may be aware, International Tractor actually has a joint venture with one of our competitors but along with that we are also doing business.

N. Sivaraman: This business is one of efficiency and quality of service, right. So whether you have a tie up or not, service is what wins finally.

Devam Modi: And what kind of LTVs do we look at in the commercial vehicle and the two wheeler businesses?

Dinanath Dubhashi: Commercial vehicle as I said, we are hardly doing any significant business now, but yes, it will be around 70% to 75% as an average. In two wheelers it can be again, in salaried it can go up to 80%, in non-salaried it will be around 65%.

Devam Modi: On the tractor side, what kind of LTV would be look at?

Dinanath Dubhashi: Again same, it depends on various schemes. It can vary from anything like 30% to 70% to 75%.

Moderator: We have the next question from the line of Saurabh Kumar from JP Morgan. Please go ahead.

Saurabh Kumar: Actually I had three questions - one is on the wholesale finance. What is this Others segment?

G. Krishnamurthy: Others - actually multiple things. One is lease rental discounting, which is not there in this quarter, but it has been there in the earlier quarters. We also have a bond portfolio today which is about Rs. 950 crores or so and which of course varies across quarters and other non-infra financing, which we have given to various companies in this segment.

Saurabh Kumar: So this bond portfolio is not to infrastructure corporates? It is not the corporate financing to an infrastructure corporate?

G. Krishnamurthy: No. These are rated bonds. Many of them listed tradable bonds.

Saurabh Kumar: Second is, if you can just share some outlook on the renewable power business. I mean your growth is pretty solid there. So from what I understand it is mostly to solar. So if you can share some outlook there.

G. Krishnamurthy: Both solar and wind are expected to maintain steady growth momentum, in fact wind has been growing very well after accelerated depreciation has been resorted. I think Q3 particularly wind has been good for us because this is a seasonal business in terms of the investments. The tariffs are typically applicable for March 31st COD, so most investments happen in Q2 and Q3, and projects come on stream by Q4. So that is one reason why you will see strong disbursements in Q2 and Q3 to the sector. In wind we see a continuing focus across all state governments. Typically we have Rajasthan, Gujarat, MP, Maharashtra, AP, Telangana, Karnataka and TN and other typical states where a lot of activities are happening in wind.

Solar we are seeing an exponential increase in the level of push by the government as also supported by a large reduction in tariff. So today we have NSM schemes where the tariff of solar is Rs. 5.5, which is pretty competitive and the government is today targeting 3000 MW on a year-on-year basis, vis-à-vis a 3000 MW installed base today. So solar is something where we will see a much larger number of projects coming on stream over the next two years because of the push the government is giving and we will continue to be focused on this sector.

Having said this, it requires a very strong technology focus to understand this sector to get the right EPC contract for people to finance, to finance right modules and right geographies. So to an extent if we see too much of competition we will continue to focus on our selectivity, even if it means losing a bit of market share. So we will continue to be focused in getting the best projects in this sector.

Saurabh Kumar: In renewable power you have grown obviously at a very high rate, 58%. Two years down what would be the growth in this segment, because this is like a primary driver.

G. Krishnamurthy: Yes. We do expect this sector to drive growth. Along with this disbursements in roads also has been healthy because of IDF and so these two have been the drivers. Given a year or so I think the rebalancing will happen when we get thermal sector as well as telecom sector back on track. So it is a question of a year, year and half or so, during which renewables will be a higher proportion of our portfolio.

Saurabh Kumar: Just on the NPL formation – It is still not coming down, it is up about 30% year on year and your coverage is still low. When do you expect this to start stabilizing for you?

N. Sivaraman: All these assets do have a consortium approach and they are like an identified asset which you can repossess as in the case of retail to bring down your NPLs. So it is a combination of both revival and maybe asset liquidation over a period of time to get the resolution on the NPLs. Just to give you an example, we had one account where we had land as the property, as a security. It has taken us about close to 2.5 years to achieve a level of resolution by liquidation of the asset. This was just to give you an example, because the process of enforcement does take time. The way we are approaching is that while there is a current value, we are also making sure that value is not eroded. It is going to take some time, so we need to really be far more conservative in terms of possibly recognizing potential losses arising from the delay, which has been taken as part of our provisioning. Corporate accounts are not going to get resolved in a hurry and that is why we have guided that while the NPA formation itself will slow down but the reduction is going to take a few more quarters.

Saurabh Kumar: But at least the year on year growth then should start tapering off.

N. Sivaraman: Yes by March. As Mr. Krishnamurthy mentioned, there are those restructured assets, which do come up for review in the next year, maybe in the first two quarters. The order inflows and cash inflows of these entities have not been as healthy as we had assumed at the time of restructuring. So as an industry we need to really look at how to really handle them. The comforting factor is that in each of these cases, which are restructured, the organization is intact. So if there is healthy order flow, they can exploit and turn around themselves.

Moderator: The next question is from the line of Nishchint Chawathe from Kotak Securities. Please go ahead.

Nishchint: This pertains to the infrastructure business, did you anywhere mention the extent of provisions that you made on SRs this quarter?

N. Sivaraman: We have provided about Rs. 17 crores on account of valuation adjustment plus maybe another about Rs. 15 crores by way of amortization i.e. the difference between the value at which it is carried and the value at which we sold.

Nishchint: On the margins side, I think somewhere in the past you have been indicating margin compression on the infrastructure side. Are we broadly done on that, because I believe you gave a guidance of stable margins

N. Sivaraman: If you look at a stable gearing level, yes, we are done. We should be in the region of close to around 4%, but our goal has been to improve the quality of the balance sheet and thereby be in a position to improve the leverage, use the Tier-2 as a way of meeting the capital requirements than raising equity. So to that extent the margin compression could happen, but that will be more contributing to the RoE.

Nishchint: And that could somehow be offset again by reducing cost of funds?

N. Sivaraman: Yes, sure. We have done some fine deals on Tier-2 even in the last quarter.

Nishchint: Sure, as far as the yield on loans is concerned – they should be broadly stable from here.

N. Sivaraman: Given the mix that we will have, which aims to have about 40% to 50% by way of operational assets, the yields should be in the 11.75% to 12.25% range.

Moderator: Thank you, ladies and gentlemen due to time constraints that was the last question, I would now like to hand over the floor back to the management for their closing comments.

N. Sivaraman: Thank you. It has been one of the more engaging conference calls. Thank you and I hope you have got most of the answers that you require, but please feel free to contact Ajay who runs the Investor Relations function to seek any further clarifications, we will be happy to provide.