



## L&T Finance Holdings Limited

### Q1-FY19 Conference Call Transcript

July 23, 2018

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**Moderator:** Ladies and Gentlemen, Good Day and welcome to L&T Finance Holdings Limited Q1 FY19 Earnings Conference Call. As a reminder, all participants' lines will be in the listen only mode. Please note that this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo from Citigate Dewe Rogerson (CDR) India. Thank you and over to you Sir.

**Shiv Muttoo:** Good morning everyone and thank you for joining us today for L&T Finance Holdings Q1 FY19 Earnings Conference Call. We have with us today Mr. Dinanath Dubhashi – Managing Director and CEO and other members of the senior management team.

Before we proceed as a standard disclaimer, some of the statements made on this call maybe forward looking in nature and note to that effect is provided in the Q1 Results Presentation sent out to you earlier. I would now like to invite Mr. Dinanath Dubhashi to share his thoughts on the Company's performance and the strategies going forward.

**Dinanath Dubhashi:** Thank you Shiv and welcome everyone to the analyst call which is of particular importance to us. We have completed one more quarter of successful execution of our strategy which we laid out two years back making it nine quarters continuously of steady improving delivery and ironically, we have had one more interesting event testing our journey to excellence. On top of the hurdles like Demonetization, GST implementation, RERA, loan waiver, local political disturbance, NCLT, IBC etc. We have had another big event happening this quarter the implementation of IndAS. As I have always said our attitude always has been of welcoming such events. As an early test to the sustainability and longevity of our strategy a test to satisfy ourselves that we are not mere heroes of good times, but the strategy is strong enough to perform and deliver in adverse circumstances as well.

We do realize that our track record of good performance is shorter than some of our peers and hence we look at such events quite enthusiastically as a chance to prove the sustainability of our concall much faster than someone else. Talking about IndAS the jury is not clear as to whether it is the hero or the villain for the performance of BFSI sector. But one thing is certain it is certainly a central character of the script and not a character artist. We believe that the way it will affect the sector, its performance, the comparison between various companies is not merely a matter of arithmetic or accounting as it is made of to be, but much deeper than that. It will test the very quality and sustainability of business models and management over a period of time. It will separate good companies and management from ordinary ones more starkly than before. It will separate the men from the boys. We of course are confident that we are on the right side of the divide and hope that we will be able to demonstrate the same to you quarter-after-quarter, but more of that later because this call becomes a IndAS call today drowning out

the performance of the Company for the quarter, let me quickly summarize the main achievements for this quarter and we will take IndAS separately as I realize that it is a very important issue but I do not want a performance of the quarter getting lost in out.

We continue confidently on our path of taking our ROE from below 10% two years back to a sustainable top quartile ROE. I of course cannot claim that this strategy which we laid out two years back has been implemented exactly as planned initially. As I have said earlier lots of events have happened over the last two years which required tweaking of the implementation plan, but the original simple strategy of Right Business, Right Structure, Right People has remained intact. So has remained intact our special formula of clear management, a well-oiled execution engine and setting up a result-oriented culture and in fact it is this formula which has kept us on course despite several difficulties.

So now to summarize our performance for the first quarter of FY19:

First and foremost, I always believe that performance and profitability of companies come from growth. We continue to improve our competitive position across products. Our focus product portfolio growth continuous to be robust growing at 27% Y-o-Y more importantly we have been able to steer the portfolio in the direction that we wanted towards Rural and Housing under our Retailization track. We have been sharing these numbers continuously with you. Today this ratio is at Rural plus housing of total now stands at 46% versus 35% in the same period last year. So, it is a big move of 11% over the period of 12 months. Our Rural portfolio growth continues to be robust of course the growth that you are seeing 100% plus is expected to be much lower mathematically once the base effect goes off from Q2, but the growth drivers of this business are all in place.

In the Housing business, the basic parameters in terms of growing home loan weightage in disbursement and growing weightage of direct sourcing within that gives us great confidence in our models. In home loans, our direct sourcing has now reached 65%. We have been sharing this number also with you as we have gone ahead. In Wholesale, we will always choose profitability over asset growth and be very selective regarding the risk return paradigm of assets we will put on our balance sheet. The AUM of our asset management business is up 60% to about Rs. 71,000 crore odd and our wealth management business is also chugging along well with a 10% growth in AUS to about Rs.19,000 crore. So, our overall business portfolio is moving in the right direction that is what we can conclude from one more quarter.

In the times where interest rates are rising our strong competitive positions in various products shift in portfolio mix no doubt it is a very important factor and prudent ALM management and strong and sustained emphasis on fee income has helped us to have a strong NIM'S plus fees ratio. This is the metric that we have been monitoring and today it stands at 6.6%. We are quite confident of maintaining at this range of course our AAA rating which we got last quarter has also helped in this. Our cost control initiatives and automation are working well despite heavy investments in technology, network and people which are of course an imperative for the Retailization program with the cost to income ratio well within control at 23.4%. Please note that this is after accounting for ESOP cost, pref. dividend and some other cost in the P&L as per IndAS.

Most importantly our asset quality both at gross and net levels is showing steady inputs. Moreover, our PCR now stands at 62% versus 51% in the same period last time. And there are provisions we are making over and above this PCR for unanticipated events risk to protect our future, but more about this later. I will

explain what this is later when we discuss IndAS specifically. As a result our like-to-like profit after tax is up by 71% to Rs.538 crore for this quarter. Our ROE for the quarter is 18.45% as against the comparable ROE of 17.19% for Q1 FY18 despite a Rs.3,000-crore equity infusion in Q4 of FY18. So, you can compare the ROA they are majorly up, but obviously debt equity is down. There is still the ROE has increased by more than 1%. We believe that this ROE is within the steady state range that we have always aiming for.

I would have loved to take shelter behind mathematics and I would have loved to claim that we have achieved our target ROE 2 years in advance. We have said we will achieve 18% in 2020. It would be so nice to say that we have achieved in 2018 itself and though technically correct this claim of earlier than planned achievement is not true in spirit, it is not correct to claim that as I will explain later. But what is indeed true is that our business model has now locked into this range of steady state ROE. What makes us confident of this fact is the strong intent we have exhibited in putting lot of legacy issues firmly behind us and by starting to build safety measures in form of strong risk framework as well as unanticipated event risk provisions for dealing with any future shocks.

So, this logically bring us the topic of the day, few things I have said in the last one or two minutes need explanation then it logically brings us to the topic of the day IndAS and the effect it has had on our business and financials. As you all know there are effects of the new standards on the way that you recognize fee income, treatment of preference dividend, recognition of ESOP cost etc, but the most important change for a lending organization is the way we recognize stress asset and provide for the same. In our Rural and Housing portfolio, we have recognized Stage 3 has all assets above 90 DPD. The ECL on the same has been calculated based on the model, based on our internal data, external benchmarks and micro & macroeconomic analytics.

While these models obviously will be further fine-tuned as we go ahead we do not claim that these models are perfect they cannot be. We have used last 5-year data, we have used external rating agency benchmark we have done our best, but we are humble enough, we are modest enough to realize that this is our first attempt at making models and this will change, this will only improve as we go ahead. So, while we recognize that the conservatism of the model even today is seen from the fact that the rural provision coverage has increased from 43% same quarter last year to 66% now. More importantly in addition to the above, we have also made a Rs. 90 crore provision for unanticipated event risk which we believe cannot be modelled example demonetization, example suddenly some political upheaval having somewhere you know at least we believe it cannot be models. And when these things happen especially in Rural business like micro loans, last eight years or ten years two events have happened already. And hence we believe that a good company a good model should continue to provide for this and then show the steady state ROE.

So, in addition to this 66% provision coverage that you see there is Rs.90 crore extra provided just for this unanticipated event risk and the profitability you see is after that. With this the asset quality both in terms of gross Stage-3 and net Stage 3 continues to improve substantially in both in percentage terms as well as absolute terms showing the quality of our rural books. We are quite proud of our efforts in terms of early bucket collections and NPA resolutions efforts which have brought the rural net Stage 3 ratio to as low as 1.73% from 6.83% in the same quarter last year and about 2.8% from Q4 FY18. Our presentation does not include this numbers of Q4. As we calculate and firm up our model up to Q4 we can take even more provisions the provisions for last year, etc., there may be some reworking, but largely it is at around 2.8% for Q4 FY18 and from that it has reduced to 1.73 in Q1 FY19.

In Housing Finance: Our asset quality as well as provision coverage continuous to be steady and we are confident that quarter-on-quarter we will improve this further as we go ahead. Now while the asset quality and provisioning in the retail businesses is making us believe in our collection and provisioning models, the quarters most notable development is in the way we have dealt with the legacy stress in the Wholesale book. I have already communicated to you that even last quarter when we met that while our Wholesale GNPA greater than 90 DPD on March 31, 2018 were about Rs. 2,100 crore, the total residual stress of the legacy Wholesale book including assets more than 90 DPD, asset with regulatory forbearance like this S4A, SDR, etc., and also standard assets with incipient stress was about Rs. 5,000 crore. We had loosely called it asset under watch or whatever.

There were various questions about what will happen if the February '12 circular is applied etc. What we have done is in the current quarter in the spirit of highest standards of governance and transparency, we have classified this entire stress book of Rs. 5,000 crore as Stage 3, included it in the financials and published. So this includes all current NPA, effect of February 12 circular and also standard assets where we believe that higher provisioning is required. So, we believe that with this argument over Rs. 5,000 crore straight recognizes Stage-3. We had also communicated that we believe that to resolve these cases we will require a total provision of about Rs.3,000 crore on this Rs.5,000 crore.

Following our aggressive provisioning over the last 8 quarters, we carried on our book a total provision of Rs.1,200 crore odd as of March 31<sup>st</sup>, 2018 and we were planning to provide for the remaining Rs.1,800 crore over the next 5 to 6 quarters. This was my communication in the last quarter. I had raised my hands and said okay our estimation earlier was not right and these are the estimates, we believe are right. As we transition to IndAS we are now taking the entire residual provisions of Rs.1,800 crore for our Wholesale stress book through the opening reserves of April 1<sup>st</sup>, 2017. In addition to this, we have also decided to provide from the P&L about 0.7% to 0.8% of the Wholesale book as steady state provisions to truly test the profitability of our Wholesale business model.

Now that the stress book is over, on the good book we will continue to provide this 0.7%, to 0.8% per quarter so that not only we are ready for the future, but also the profitability of the model is well tested. With this now, our gross Stage 3 of Wholesale book stands at Rs.5,058 crore and net Stage 3 stands at Rs.1,846 crore and for provision coverage on our entire wholesale stress book and not only NPAs is at 64%. Thus, with the legacy stress book fully recognized in the financials and provided as explained above, we believe that this issue is now well and truly behind us. We are also confident that this pain we have experienced over the last two years, had prevented us to showcase our true profitability, as we have been constantly providing for the same.

This pain which had constantly led to doubts and questions about our portfolio quality will never be seen again. What gives us this confidence are the following measures: one, our focus on a zero DPD portfolio, here it need to be pointed out that out of the total non-Stage 3I intra portfolio that is out of the performing infra portfolio of Rs.29,000 crore around less than Rs.4,000 crore is under construction and the remaining operating projects. This gives us this confidence that our zero DPD book is good and will continue to be good. Second, a strong risk framework with clear portfolio limits and earning warning signals. And third most importantly as we communicated last quarter a separate special situation group has been created to concentrate on the resolution of this stress book.

This gives us the confidence that this is well and truly behind us now. Our overall gross Stage 3 ratio for the entire businesses put together now stands at 7.9% versus 11.7% same quarter last year and the net Stage 3 ratio now stands at 3.2% versus 6.1% for the same quarter last year. The approximate corresponding numbers for Q4 and I am specifically giving them because there is confusion, comparing NPAs of last quarter, etc., so the comparable Stage 3 numbers gross and net for Q4 are 8.7% and 3.5%. So from Q4 also there has been improvement in Q1 this year. With this, we believe that at Wholesale and overall levels we are at a point where stress is fully-recognized in the book and our portfolio risk management measures, special concentration on early bucket collections, enhanced efforts on NPA resolutions and most importantly conservative provisioning will ensure that our net Stage 3 ratios will directionally only improve from here on.

This has been fairly long opening remarks, but I hope I have done justice to complete clarity and transparency on this topic and as always making the management intent very clear. I would love to spend time talking about each business, market, etc., but I will leave that for your questions if any or further meetings that we may have with some of you individually.

Let me conclude my opening remarks by reiterating that the basic parameters of our business model are robust and intact, and we have demonstrated that through various parameters for one more quarter making it a steady and sustainable improvement journey of nine quarters in all.

In addition to a robust business model, the problem of legacy stress in the Wholesale book provisioning which subdued our performance for the last two years is now firmly behind us. With this we believe that we have locked in our ROE within the range of what we believe is steady state and sustainable ROE for our business model. The increase in ROE from IGAAP which was around 15% more or less last year to IndAS 18.45% can be looked at perhaps little bit frequently as near arithmetic. Higher numerator on a lower denominator naturally the ratio will go up, but it is deeper than that in its true spirit it can be seen this 18.45% can now be seen as the ROE the business is capable of producing sustainably in the future even as we recoup the reduction of Networth pretty quickly. So we will be recouping the Networth very easily because we were providing the Rs.300 crore to Rs.350 odd crore on Wholesale every quarter, now we will not be providing that. We will be providing only about Rs.90 crore which is the steady state. So the ROE will be recouped pretty quickly even as we recoup the net worth, the ROE will remain within this steady state.

This management has always made its intent very clear. So I will end my opening remarks with making clear our intent and responsibilities for the future:

1. While we have designed our ECL model, with all best intent and conservatism, we recognize we are modest enough to recognize that these have to be constantly fine-tuned with the passage of time and availability of more data. While today, these are made product wise, we will constantly work for making these even more granular. In fact, we are keen that ultimately ECL model should be used to steer each portfolio towards the best risk/return paradigm.
2. We will continue to build on the strong competitive strength we have built to ensure a steady book growth, strong NIM plus fees and steady Retailization of the portfolio. Most importantly, it will be our endeavor to make sure that our portfolio quality in terms of both gross and net stage-3 ratios steadily improves from here.



***In summary, having reached a steady state top quartile ROE, from now on our focus will be on maintaining the steady growth, maintaining the ROE within the steady state range and minimizing sigma through tightly managing all the families of risk. Our clear intent is to ensure that the bad times we have seen will never be repeated and having gained your trust and credibility we will never lose it again.***

Thank you, ladies and gentlemen for your patient listening. We are now open for questions.

**Moderator:** Thank you very much. We will take the first question from the line of Kunal Shah from Edelweiss. Please go ahead.

**Kunal Shah:** Sir, just wanted to get the sense in terms of the reconciliation of FY'18 profitability, so we have disclosed Rs.1,275 for FY'18 under IndAS and what was there under the GAAP earlier. So what would be the broader movements in terms of the impact of the fee income and the provisioning on that, so if you can just give the reconciliation across four, five broad items?

**Dinanath Dubhashi:** So largely, what we have changed in FY'18 is the pref. dividend and the ESOPs mostly. If you just put the ESOP cost and take the pref. dividend above the line, you would largely get that number. If you contact one of us, we will give you very precisely the reconciliation for Q1. We are still as I would say fine-tuning the Q2, Q3, Q4 for last year and by next quarter we will give the complete reconciliation of FY'18 between IndAS and IGAAP as we are still perfecting the last year's ECL calculations, etc., largely the difference is pref dividend and ESOPs, some amount of fees, amortization etc.

**Kunal Shah:** Yes, but ECL also would be a major component right because since in say first half of April 2017 we had taken this entire hit. So whatever excess provisioning maybe which we were doing all through, that would not have been needed. So I think that goes out...?

**Dinanath Dubhashi:** Good question, I think this is the question that is important for clarifying. So what have we taken? The Rs.1,800 crore was the remainder after taking Rs.1,200 crore. So I have not disturbed what we had taken in FY'18. Only the incremental Rs.1800 crore has been taken. Otherwise it would have been an arithmetic exercise.

**Kunal Shah:** So whatever was the accelerated of say Rs.222 crore and maybe one when we look at in terms of the ...?

**Dinanath Dubhashi:** We have let it be there.

**Kunal Shah:** Okay, so everything stands as it?

**Dinanath Dubhashi:** Correct. Only what was remainder we took it from the net worth.

**Kunal Shah:** So now incrementally in terms of credit cost, you highlighted in terms of the Wholesale what we are looking, but when we see the overall book, what should be the steady state credit cost now on after taking this kind of hit?

**Dinanath Dubhashi:** I will be able to tell that as we go ahead more. In Wholesale I can be able to make more clear that we will take between 0.7% to 0.8%.

**Kunal Shah:** Overall should settle somewhere around 1.5 to 1-point...?

**Dinanath Dubhashi:** Yes, it is around 1.6%. Why I am being uncharacteristically not very clear about this, I will clarify, is this Rs.90 crore that we have taken in micro loans, we have taken one Rs.90 crore in Rural, right, that Rs.90 crore is included in this 1.6, but it does not follow any model. That Rs.90 crore is currently our estimate of what we believe is we call unpredictable, uncertain events that can happen, and we have just provided Rs.90 crore. We will have to see that for how long we will have to create this and till what time we think that buffer is enough. Till then we will keep providing it, after then the credit cost will suddenly come down, because other than this you would see that the provision coverage is already quite high on stage 3. This Rs.90 crore is not on stage 3 right because when an event happens not only stage 3 will go bad, right, stage 1, stage 2 can also go bad when something like demonetization happens and hence we believe that other than PCR on stage 3, we also need to provide something on the overall book which will not be in the model. The model itself provides for a good enough amount on stage 1 and stage-II but in addition to this, we have provided this Rs.90 crore. So net-net yes, you are right, I can say that our aim will be to bring the overall credit cost below 1.5 definitely but that will happen after we create a good kitty. I always talked about management intent, right. This management believes in creating a kitty when the going is good rather than providing and taking hits to the P&L when going is bad and right now going is good, so we will keep creating this kitty.

**Kunal Shah:** The other thing with respect to IND AS maybe with respect to effective interest rate as well as the impact on the fee income since our fee income also over last four quarters as well as in Q1 has been higher. Because of the sell-downs maybe how are we seeing overall impact because largely you said it is ESOPs and preference shares which is impacting, but how about the fee income and even effective interest rates maybe the way that escalations have changed, is it having any positive impact overall in the P&L?

**Dinanath Dubhashi:** On interest rate there will actually be a small negative impact as we will take the cost of raising the debt, not the cost of debt but cost of raising the debt also in interest rates. Cost of raising the debt initially could be taken against share premium reserve. Now it will fully come in P&L, meaning the brokerage that you pay. Preference dividend is just arithmetic entry. We used to always show PAT to the shareholders, we used to always calculate ROE after pref dividend. So pref dividend that is it. I have explained to you the cost of raising debt, now fees. Now, let us just see what are the kinds of fees that we have? In retail, you charge processing fee and you spend against that, you spend whatever you have to pay to intermediaries for checking on the loans or etc., etc., documentation, origination cost, you charge off against that, only what remains is what you amortize over the loan book. On Wholesale also, only the fees that you are earning on the book that stays with you, you have to amortize. Book held for sale you do not need to amortize because it is like merchant banking/ investment banking fee. So as we sell the book, the entire fees can be recognized. So the effect on our fees is there of course but it is not major. Because we are always amortizing fee, there is also the population of unamortized fee, that is on our balance sheet, so that will come in addition now to the fees that we have actually earned. So there is the fees that we earned, addition of unamortized fees which we have not recognized in the past, which will come and subtracted will be fees that we are amortizing for the future. The effect of all these on our business model is very minor.

**Moderator:** We will take the next question from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

**Amit Premchandani:** Sir, in terms of rural and housing credit cost, is it safe to assume that IndAS has not impacted FY'18 numbers at all in the P&L?

**Dinanath Dubhashi:** Yes, it will be safe to assume that because we have been providing also well in excess, no major changes, you are right.

**Amit Premchandani:** So whatever changes in credit costs which have happened, and which are likely to happen going forward, will largely be led by wholesale only?

**Dinanath Dubhashi:** So two things as I explained; Wholesale will reduce drastically obviously, because Wholesale now what we are providing just based on a percentage of portfolio, it is not credit cost against actual identified assets. We can predict that 0.7%-0.8% is what we will take... hopefully little bit more also we will be able to take as we earn more. But that is what we will make and provide. Retail and Housing will largely follow the model but in addition to that we hope to make a similar kitty like to put it for any untoward event in the future.

**Amit Premchandani:** Are you comfortable with 60% coverage for Wholesale given that except the steel cases in NCLT, most likely the coverage or the loss given default will be slightly higher?

**Dinanath Dubhashi:** It is 64%, we are largely comfortable with it, if 1% to 2% here or there will happen we will manage, but that is it, we can manage with 64% and numbers like Rs.5,000 crore difference between 60% and 64% is larger, it is Rs.200 crore.

**Amit Premchandani:** Sir, what is the impact on tax rate of IndAS given you had created a goodwill and you were using that to take provisions and against that there was a tax benefit, so what is the outstanding pool of that tax benefits still lined and how is it accounting for, what will be the change of tax rate which we can see in FY'19? Also, if you can share with us the capital adequacy ratio?

**Dinanath Dubhashi:** So tax benefit is simple; the tax benefit continues we hope that tax has nothing to do with IndAS. Now these are some of the caveat emptor which every CEO now has to meet because who knows, right now IndAS has come, what will the tax authorities follow, we do not know, generally speaking, whether they will follow IndAS, they will follow their own norms, etc., this will know only when after a couple of years when we file this and our assessment will come up, etc., But having discussed in detail, got enough opinions of tax experts, we believe that this Rs.225 crore per year it will continue, it will continue for the next three years, that is FY'19, FY'20 and FY'21. The effective tax rate, simple question. My answer remains same -- You take the PBT, multiply it by 34.608% and subtract Rs.226 crore from that, that will be our tax. There is a capital adequacy. I would like to make one thing clear that till NBFCs even today are not clear what we have to report to RBI. The Reserve Bank of India has not come very clearly regarding how we report for regulatory purposes. So the industry has taken a call that the reporting to RBI will be based on RBI norms only. Because I want to give you both the answers, based on RBI norms, the capital adequacy is 19% and based on IndAS calculation it is around 17%. So in both the cases, we are pretty comfortable.

**Moderator:** Thank you. We will take the next question from the line of Rohan Mandora from Equirus Securities. Please go ahead.

**Rohan Mandora:** If I look at your 1Q FY'18 Vs 1Q FY'19 reporting based on IndAS, in the real estate finance book, the credit cost for housing business increased from 0.9 to 1.34, it is on Slide #40, so are we seeing some incremental stress building up in that portfolio and also the disbursements were flattish in terms of the real estate finance, so just want to get your sense on this?

**Dinanath Dubhashi:** I will answer both the questions, I will answer the second question first. The disbursements are indeed flattish. As we had always shared, we are being more and



more selective, we are concentrating more than 90% of our disbursements are now to Category-A developers. As we go ahead, we will be even more conservative in our disbursements to this sector and at Rs.1,500 crore we believe that the disbursements are at a good level, the growth, the Rs.1,500 crore will be what, six tickets, seven tickets, something like that. So growth number on a quarter basis can be zero, can be 35%, can be 50%, these are chunky tickets. But what we have seen this time, the growth in the real estate it is absolute flat. I can say that we just have been very-very selective vis-à-vis the risk/return paradigm, same in Wholesale, Wholesale we have been very selective, the disbursement growth is negative, the book growth is negative, it is all according to me showing our conservatism as we go ahead. The growth however in the retail housing book is 30% and within that too, the percentage of home loans in the disbursements have gone up, percentage of direct sourcing within that have gone up. So the retail model of housing is moving in the right direction. So that is the first question. Second, you are talking about some additional stress. We do not believe so generally speaking. We had a legacy portfolio here also a little bit but we have taken over from Citi and from the original portfolio when we took over this company, we have sort of decided to write off a large part of it and gone ahead with that. As we go ahead quarter-to-quarter we believe, and I said in my opening remarks we believe that this number should steadily come down.

- Rohan Mandora:** Just a follow up to that, trade loss we are building in our IndAS model for 1Q'18 and 1Q'19 because we are building 92 basis points of credit cost for 1Q'18, 134 for 1Q'19, I think the underlying assumption would have been similar. So what explains the increase because in Wholesale we are seeing a decline because the provisioning account has gone down
- Dinanath Dubhashi:** I told you the increase is largely because of the write-offs we have taken in some of the legacy, we have used this to clear the portfolio, it should settle at around 1% in the short-term and then hopefully move on from there.
- Moderator:** Thank you. We will take the next question from the line of Saurabh Kumar from JP Morgan. Please go ahead.
- Saurabh Kumar:** Sir, just wanted to know of the micro loans of this Rs.9,000 crore, how much will be micro finance now and how it would have grown over the last one year?
- Dinanath Dubhashi:** We have actually stopped tracking that. We are very clearly acknowledging the fact that hardly any customers of ours will be less than that Rs.1 lakh income level, so we have no claims to that any funding advantage or sell-down advantages which are coming out of maintaining the specific micro finance portfolio, we are letting go of those because genuinely we believe that lending above that one lakh level. By the way I must clarify that even in micro loans we do 100% JLG, but it is just that I would think more than 90% of our customers will be more than Rs.1 lakh income. So we do micro loans and if that means letting go of a few basis points of funding cost so be it.
- Saurabh Kumar:** Sir, just on Housing vertical, your average yield on the book is 12%, but just on the real estate finance part, the yield should be 15%?
- Dinanath Dubhashi:** Around 14% it would be.
- Moderator:** We will take the next question from the line of Dhimant Kothari from Invesco Mutual Fund. Please go ahead.
- Dhimant Kothari:** The first thing I wanted to know is the GS 3, we have provided it on Slide #14, what was it for the end of FY'18 both for wholesale and consolidated?

- Dinanath Dubhashi:** Consolidated was 8.7% gross and 3.5% net. Wholesale was 11.9% and 4.65%.
- Dhimant Kothari:** Secondly, the Opex growth in the wholesale seem to be very large this quarter. So anything exceptional in that?
- Dinanath Dubhashi:** We have added people, we have increased salaries, ESOP cost and there is one one-time item, in Q4 we sold our investment of Feedback Ventures, so there were some cost related to that sale which got accounted in Q1... they should have ideally been accounted last year, it was an error, so it was some Rs.7, 8 crore something like that.
- Moderator:** Thank you. We will take the next question from the line of Karthik Chellappa from Buena Vista Fund Management. Please go ahead.
- Karthik Chellappa:** Sir, you mentioned that surplus provision you have taken both on the retail and wholesale for unanticipated risk is about Rs.90 crore which is let us say about Rs.360 crore annualized. So if I look at let us say the whole retail book of about Rs.40,000 crore and the wholesale book of Rs.45,000 crore, it works out to about an extra of 80-90 basis points. Does it mean that henceforth our standard asset provision effectively be 3x of what the mandated norms are?
- Dinanath Dubhashi:** Good question. So let me try and clarify what these various numbers are. Right now, let me tell you what are our Stage 1, Stage 2 are. So our Stage-1 at this point of time overall is at around 0.4% provided and Stage-II is around 6%, total provision and then the Stage-III you already have. This is what the formula says. Now what we are also doing is #1, Wholesale and Rural what we have done are two different things, those numbers are similar Rs.90 crore just by coincidence. Wholesale what we are doing is just to test the profitability of the model and also to make sure that we do not do the mistakes that we did five, six years back, 2011 when the infra was making 18% - 19% ROE in 2011, we had not provided anything saying that the book is standard, etc., Yes, we have realized with a lot of pain that things can happen and the portfolios can go bad and hence we are providing for the future, 0.7-0.8% today and hopefully going up to 1% of the entire wholesale portfolio as steady state provisions. While the remaining Rs.3,000 crore provisions are identified asset wise, these provisions are not asset wise, these we are making a provision for the future, may be, somebody asked me that whether 64% is enough or not. Yes, maybe what if we are wrong, and we require a couple of hundred crore more. All these questions are answered by taking those Rs.350- Rs.400 crore per year more on Wholesale, that is #1. Now Rural, especially on micro loans actually, industry has been scared twice in the last 10-years by events which could not have been modeled, right, suddenly a demonetization could not have been modeled. So it is the modest recognition of the fact that however a great model you make there will be times when there will be unanticipated events and there is a risk. Now why Rs.90 crore, why not Rs.100 crore, why not Rs.50 crore? Tell you the truth this quarter I could afford Rs.90 crore because there is no model to show that Rs.90, Rs.100, Rs.110, Rs.60, etc., right. So every quarter whatever we can afford we will keep it aside, it is absolutely like ant keeping things for the winter day. It is really to be taken in that spirit and not in any ratios. That is the difference between these two provisions; Wholesale is a ratio, Rural we are making a lot of money, we are just keeping some assets for things which cannot be anticipated. At one point of time we may feel that now it is enough, we can't take any more event risk then we will stop it.
- Karthik Chellappa:** Just one follow up on this thing, if I look at your presentation especially on the Rural book, especially the two-wheeler portfolio, in the last four quarters, there have been steady increase in the average ticket size, four quarter back it was about Rs.49,000 going up to Rs.50,000, Rs.51,000 and now we are at Rs.52,000. Similarly, for the

tractor portfolio, in the past we used to say four years, 48 months, 49 months that has come down to 46 months. Anything to be read into this?

**Dinanath Dubhashi:** It is. The first one is just inflation. LTV actually if at all have only come down, that much I can tell you very-very clearly, that our LTV across books have come down but asset prices have increased way more than what you are seeing. In tractors, we had some assets which are six years, seven years, etc., we have seen that the performance of those portfolios is by a step worse than portfolio which is less than five years and hence we have stopped doing those schemes and hence the average tenors of the portfolio has come down.

**Moderator:** Thank you. We will take the next question from the line of Alpesh Mehta from Motilal Oswal Securities. Please go ahead.

**Alpesh Mehta:** On the strategic side, how are the rating agencies looking at this the entire hit on the net worth?

**Dinanath Dubhashi:** The hit on the net worth is all in the mind, because within four quarters to five quarters we will recoup them. So we have had discussions with them. Generally, we have been telling them that there is an issue of Rs.1,800 crore to be incrementally provided for. The upgrade was after making this Rs.1,800 crore of remaining stress very clear to them. So we do not expect a downgrade if that is your question.

**Alpesh Mehta:** Because normally they also look from debt-to-equity perspective ...?

**Dinanath Dubhashi:** Downgrade will not happen, that is our confidence.

**Alpesh Mehta:** Secondly in Stage 1 and Stage 2, would you be comfortable sharing the probability of default and the portfolio lying into each of the products?

**Dinanath Dubhashi:** Not yet. Everything is developing and changing. There maybe peers who are very confident but we are now building, there will come a time when we will share. I just shared with you the provision coverage in each one of them. Going into the details of the model not yet. What we will show is our provision coverage only becomes more and more conservative. So once again to be clear, if you are feeling that we will keep it as a secret and reduce the provision coverage in the next quarter, I will not do it. Do not worry.

**Alpesh Mehta:** Third question is if I look at the earlier GAAP related disclosures and if I look at the Wholesale stress pool and the Rural and the Housing stress pool, all put together was around Rs.5,000 crore in 1Q FY19, I am comparing Y-o-Y whereas right now we have reported around Rs.5,500 crore of 1Q FY'18, only Wholesale was around Rs.3,600-Rs.3,700 something. This Rs.500 crore is it because of the RBI guideline of reclassification?

**Dinanath Dubhashi:** I will tell you, it is very simple in Wholesale there is an NPA, impaired assets and standard assets where we thought there is incipient stress were not included, now we are including that but you remember Alpesh that I used to always talk about that number.

**Alpesh Mehta:** Under IndAS, there are certain provisions available wherein if the loan fees or the processing fees which are integral or the non-integral the way you classify it, and accordingly you need to amortize, or you can take it upfront, so are we changing any of the definitions related to that, economically nothing changes is just from an economic perspective, wanted to get some clarity?

- Dinanath Dubhashi:** I explained to a previous question that what we are amortizing and what we are not. In both the retail businesses, the fee earned minus the acquisition cost if any is amortized. Cross-selling fees, etc., not amortized. In Wholesale fees, processing fees on assets held on book are amortized. Assets sold down are not amortized, very simple, everything is for accountancy.
- Moderator:** Thank you. We will take the next question from the line of Pritesh Bumb from Prabhudas Lilladher. Please go ahead.
- Pritesh Bumb:** Sir, wanted to know about the gearing in the individual businesses. We used to always tell that we will put more capital into the Rural and Housing side and then Wholesale. But when I see the gearing ratios, you have 6x in housing and little bit lower of 7 in your rural side and 7 in the Wholesale business. How do we see that now going ahead?
- Dinanath Dubhashi:** All those are after we infused capital and then Rs.1800 crore has been taken away. So that will quickly recoup as quarter on quarter go through by profits.
- Pritesh Bumb:** Wholesale will not require any infusion of capital?
- Dinanath Dubhashi:** Not further than this. So, Wholesale ROE is already seeing at about 15-16%. The growth in portfolio will be lower than that.
- Pritesh Bumb:** Sir, you have added about 3,500 employees' quarter-on-quarter?
- Dinanath Dubhashi:** That is right, on account of Retailization.
- Pritesh Bumb:** But if I look your meeting centers would not have increased by 175, where is this deployment happening of employees, basically I will assume more manpower is required on the rural business side?
- Dinanath Dubhashi:** Yes, meeting centers have increased, you are right, it has not increased by 175, it has increased by 250 after the quarter end. The manpower is mostly being added at Rural, lot of it in Housing, some in head office as we are getting into this digital and all, working of all this in the analytics team, etc., but large part of it obviously to support the rural growth clearly.
- Pritesh Bumb:** The cost-to-income is that steady state type of number of which...?
- Dinanath Dubhashi:** Good question. You know at this point of time, it looks like steady state, may go up for the couple of quarters more, we are investing even more not only in IT, but also now in some of the head office functions improving further our quality of manpower. So may be in next one year it may creep up to around 24 or so, but largely yes, say in the next four or five years, 22, 23, even little bit less than that is possible. Additional cost has been taken due to valuation of ESOPs as per Black Scholes Options pricing model under IND AS
- Moderator:** The next question is on the line of Nischint Chawathe from Kotak Securities. Please go ahead.
- Nischint Chawathe:** Just one clarification and one question from my side. First one is on the stage1 coverage of 0.4% and stage2 of 6%, this is for the rural book or for rural and housing book both put together?

**Dinanath Dubhashi:** Rural and Housing is totally around 4% and in Wholesale stage2 is around 8%, that is how it is 6%. Stage1 is largely 0.4%, rural will be 0.8% or something.

**Nischint Chawathe:** Just one more data point understanding. This valuation of investments of Rs.226 crore in the opening net worth, this is what?

**Dinanath Dubhashi:** These are two investments; one of them we have actually already sold, this is the difference between the acquisition cost and fair value at that point of time. We have two accounts that are under IndAS, under IGAAP anything plus in MTM was not accounted for.

**Nischint Chawathe:** And this is based on assessment or auditor?

**Dinanath Dubhashi:** In fact, one is sold and after selling we have made more money than that.

**Nischint Chawathe:** The other thing was just your outlook on how do you see the Rural business playing out given the fact first quarter was very strong?

**Dinanath Dubhashi:** Good, this is what I said that I will try to answer during the questions. So yes, first quarter was very strong, but in terms of percentages... before I answer, let me give you caveat emptor that do not look and get carried away by the percentage. These percentages will not be sustainable for the simple reason that from Q2 last year, our growth in Rural had really started. Till Q1 last year we were still recovering from demonetization. So the real growth and the real potential of the business to show growth will be seen from Q2, which we believe should be around 30%+ but definitely not sort of 100% and 127%, etc., that is simple. In fact if you see the disbursement of Rural Q1 over Q4, it is largely flat, micro loans is flat, we believe we are now disbursing close to Rs.3,000 crore a quarter run rate, actually in June we disbursed almost Rs.1,000 crore. We will like to first consolidate at these run rates and make sure that operations risk and all other risks are very well taken care of at these run rates. We have been running very hard in Rural for the last 18 months or so. I think for one quarter at least, steadiness in this rate, so what we believe is Q2 should be more or less same as Q1, in terms of total disbursement. In the meanwhile, we will really-really tighten. What I said in the beginning that all families of risks we will control and that is really the intent of management. We will make sure that we take a small pause in the quarter-on-quarter growth and make sure that the operating risk in Rural are well taken care, because we now believe that the credit risks are very well in control based on our portfolio, the credit engine as well as early warning signals, what we need to further tighten is the operations risk and that is where there are projects which we are working, and we will do that. As far as sector outlook is concerned, the tractor outlook obviously remains very positive about 10% growth overall is expected, we are outperforming the market even next few quarters as we consolidate, we will continue to outperform the market. More importantly our share of what we called our "Preferred OEMs"- which is Mahindra Group, TAFE Group, JD is more than 80% now. In tractors, our zero DPD is coming close to 80% and it is really all-time high, so tractors everything going well. Micro loans as you have seen our NPAs are down, our collection efficiency is 99.6% now, so back to that we have reached the run rate of Rs.1,000 crore per month and we should be able to continue that for some time. So that portfolio also doing very well. The big growth which we think that we will see this second quarter as we saw in first quarter will be in two-wheelers. That is where we are genuinely consolidating our gain. We are increasing what we call our fortress locations and number of locations where we are number #1 or #2 is looking very-very robust now and continuously gaining market share there as well, that industry also seems to be doing really well. The Scooterization continues, our deep relationship with both Honda and TVS is working very well there. So, as I said in my opening remarks, all the business parameters as well as collection parameters

look very robust in rural. The growth rates however till first quarter need to be taken with taking the base in the picture.

**Nischint Chawathe:** Just one clarification, the zero DPD in tractors is 80%, what could have been at the most difficult time?

**Dinanath Dubhashi:** We had earlier reached a level which was below 50%.

**Moderator:** Thank you. Next question is from the line of Nitesh Jain from Investec. Please go ahead.

**Nitesh Jain:** Sir, on the stage1 definition, in the presentation you have mentioned that it is 30/60 DPD. So in which product lines you have used 30 DPD and in which product line you have used 60 DPD if you can...?

**Dinanath Dubhashi:** Wholesale is 60, everything else is 30, Wholesale is 60, there is a rebuttal available and we have been able to prove to Deloitte, our auditor that anything between 30 to 60 the chances of it becoming stage-3 is about 1% and based on that we have been able to rebut the stage-2 to 60 DPD and the retail portfolio we have kept it at 30 DPD.

**Nitesh Jain:** Wholesale and real estate finance as well or no?

**Dinanath Dubhashi:** It does include real estate.

**Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference back to the management for their closing comments. Thank you and over to you.

**Dinanath Dubhashi:** Thank you for your questions, I was able to clarify many things which I was not able to clarify during my opening comments ...I think my opening comments were pretty long and I do not want to add up too many things to this, but few things that I would like you to carry with you is #1 that IndAS accounting models are evolving. Anybody who claims that they have gone on the top of the model needs to be taken with the pinch of salt. We have used as much data as possible, but as we get more and more data, we are modest enough to recognize that this will evolve. But intent of this management is to make sure that as they evolve, they become more conservative and not more relaxed, so that is #1.

Second important point is our entire legacy stress in Wholesale book which was the topic of discussion and lots of questions, to me and rightly so, is now well and truly behind us. We are going out and committing and making our intent very clear that from now on we will see only directionally this stress at gross and net level only reducing from. Last but not the least, having taken this Rs.1,800 crore straightaway from net worth may seem like arithmetic at this point of time, but this net worth we will recoup in double quick time, #1, and #2 the ROE, that every business as well as overall has been now locked in is we believe what is steady state ROE, we will be able to maintain this ROE, we will be able to maintain excellent growth and most importantly the intent of the management is to make sure, make it absolutely sure that all families of risks are managed pretty well so that such shocks never come again, the sigma remains minimal and ***in fact in our internal lexicon which I have been sharing with you, we have actually launched a campaign saying "Never Again." The pain that we have seen, the loss of confidence that we have seen, the loss of credibility that we have seen, because of this legacy issue in Wholesale, this company will never go through it again.*** Thank you all for your confidence and for your support.