



L&T Finance Holdings Limited
Q2 FY20 Earnings Call Transcript
October 22, 2019

Moderator:

Ladies and gentlemen. Good day and welcome to L&T Finance Holdings Q2 FY20 Earnings Conference Call. Please note that this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir

Shiv Muttoo:

Thank you, Stanford. Good morning, everyone and thank you for joining us for L&T Finance Holdings Q2 FY20 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 today's call may be forward looking in nature, and a note to that effect is provided in the Q2 Results Presentation sent out to all of you earlier

I would now like to invite Mr. Dinanath Dubhashi to share his thoughts on the company's performance, and the strategies of the company going forward. Over to you, sir

Dinanath Dubhashi:

Thank you, Shiv. Good morning to all of you, and welcome to the analyst call for the second quarter. In a quarter where there has been lots of news flow, mostly negative, for the sector, LTFH is happy to report good results. We have tried to handle the negatives by staying prepared in advance, concentrating on doing the basics right and keeping our focus single mindedly on the execution of our strategy blueprint, which was the revised strategy blueprint unveiled 6 months back. There have also been couple of good measures taken by the government and some good developments in the underlying sectors that we operate in and we have taken full advantage of these to improve our profitability, health of balance sheet and business strengths. Let me first quickly summarise the highlights of the quarterly numbers and then I will speak about the developments and more importantly the outlook in the sectors we finance, and its effect on us in the near future

Our PAT for the quarter before a one- time DTA (deferred tax asset) impact is Rs. 647 Cr, which is a 15% yoy growth over Q2 FY 19. The fundamentals which contributed to this were the following:

- Our focused book grew by 19% yoy with Rural and Housing growing at 24% each and Infra Finance at 13%. With this the Rural and Housing businesses now add up to 53% of the total book, in line with our retailisation strategy
- You would also remember that in line with our strategy to further concentrate on businesses where we have a clear Right to Win, we had classified SFG (Structured Finance) and DCM (Debt Capital Market) as defocused earlier this year. As we have demonstrated in the past too – 3 years back, we had put 16 businesses under defocused book and had been able to run them down rapidly. In the same way, we have been able to run down this defocused portfolio pretty rapidly by 45% yoy from ~Rs. 13,200 Cr last year to ~Rs. 7,200 Cr. It has been by a mix of strategies, DCM has liquid securities that can be sold in the market and in Structured Finance, through scheduled repayments as well as prepayments through various strategies
- On the liability side, as always we continue to maintain good liquidity with positive gaps in all buckets up to a year and adequate liquidity even assuming a 1 in 10 stress scenario in the first month bucket. We have further reduced our CP% to 10% even though the cash flows, especially from rural, allow

for a much higher %, just to be extra cautious in today's environment. We also diversified our funding mix further mainly through ECBs, preference shares to HNIs and taking full advantage of RBI's decision to allow loans taken from banks for on-lending to agri sector to be classified as Priority Sector Loans (PSL) for the banks. We were able to raise more than Rs. 1,400 Cr through this route and intend to raise much more in H2. As far as ECBs are concerned, we have raised ECBs in the last quarter from IFC. In similar way, we have got ECBs sanction from AIIB (Asian Infrastructure Investment Bank) which is the first ever loan given by AIIB to an NBFC in India. These are some of the marquee loans we were able to raise. Despite reducing the % of CPs to just 10% our cost of funds remains well in control at 8.61%

- Our strategy always has been to protect our top line in form of NIMs+Fees through effective transmission of pricing (wherever applicable) and fees through cross selling. Our business model is built for maintaining NIMs+Fees in the narrow range of 6.5-7%. In Q2 FY 20, we were able to keep NIMs+Fees at 6.86%. Over several quarters now, through interest rate and business cycles, we have shown resilience and our pricing power by maintaining this range of margins and this gives us tremendous confidence in the strengths we have built in our businesses
- Asset quality has remained well in control. There is a small increase in Farm GS3 mainly due to cyclical factors and also some temporary issues in flood affected areas. We expect this to come down again in next quarter. The lower provision coverage in Rural is actually an indicator of debt, as seasonally billing which has happened 3 months back become NPAs in September and March. The aging of these NPAs will be just above 90 days and hence the provision required for that is negligible. As a result, you will see provision coverage seasonally coming down as the GS3 goes up. This has happened only in Farm, not in Rural as a whole and we are confident we will see a reversal in December itself. Thus a steady performance across the entire ROE tree has effectively helped us deliver a 15% growth in profits, of course helped by the lower tax rate as well

That brings me to 3 more specific developments I would like to highlight for this quarter:

1. First is the change in tax rate from 34.94% to 25.17%. LTFH has decided to opt for the lower tax rate. While this will lead to substantial benefits every quarter from now, there is a one-time impact of reversal of DTA, which we carry due to substantial provisions created in order to strengthen the balance sheet over the last 3 years. This has led to a one-time impact of Rs. 473 Cr and we have chosen to take the entire hit in Q2 itself. While this hit is one time we will benefit substantially from now on every quarter. The ROE for the quarter before this one-time impact is 18.13%. Another adjustment you will need to make is that in this quarter, we have benefitted from the lower tax rate not only for this quarter but also for Q1. Even if we adjust this for the benefit of lower tax from Q1, the ROE works out to about 16.2%. The steady state RoE has been maintained upwards of 16%
2. The second specific development I would like to point out is the sale of our wealth management business. While we had built a profitable business model, it accounts for less than 1% of LTFH revenues and profits. With the change in various regulations, the business requires a full suite of in-house products and services necessitating a larger wealth platform. LTFH has entered into a definitive agreement to sell 100% stake of L&T Capital Markets (the vehicle doing the domestic wealth business) to IIFL Wealth. The transaction is in process and regulatory approvals are awaited. We hope to close the transaction in Q3
3. The third and perhaps the most important development I would like to highlight, is that in a climate where a number of companies are getting downgraded, CARE, ICRA and India Ratings have reaffirmed the AAA rating for LTFH and all its lending subsidiaries in August and September 2019. Additionally, on 4th October 2019, we were assigned AAA rating by CRISIL as well. AAA rating from 4 rating agencies indicates a strong and diversified presence across sectors, focused and predictable business model, strengthened risk profile and asset quality and last but certainly not the least the strategic importance and strong support to financial services business by our parent L&T

Now, let's briefly cover each business and the outlook for the same:

1. **Rural:** The overall slowdown in the economy also affected this sector. We, in the H1, concentrated on maintaining our business strengths and competitive position in such a scenario

a) **Tractor:** Market saw a de-growth of about 10%. We kept our market share by concentrating on capturing higher counter-share of our chosen dealers through a differentiated value proposition. Now this is important, whenever I have spoken one-to-one to any of you, we have explained the way we do budgeting. While we make a yearly budget, our budget given to every branch is very dynamic, we change it every quarter and in some areas, even monthly. And we specify that based on our analytics - which dealer, which model, at what LTV we want to do business. All this is centrally decided based on how the portfolio of that particular dealer, that particular model is behaving. And hence, whether rains are good or bad, markets are good or bad, we are able to concentrate on specific dealers and we know where to take our counter share quite high. So, we do not go by the often repeated things such as - the growth is too high, or the growth is low, so let's go slow - No. Both in Farm and in Two wheeler, we know precisely which dealer, which model, at what LTV we want to do business. And that we can invest there, we can put our people there, we can strengthen our network there, and that's how we maintain our market share or maintain our growth

So, growth is the resultant of increase in counter share in each of the dealers that we concentrate on, and then it adds up to a number and if that is growth, good enough. If that is not growth, so be it. We will always be sure of the asset quality that we built because of this kind of concentration. We have also increased business by focusing on refinance, top up and used tractors. We used data analytics extensively for OEM classification and categorising geographies into focused, calibrated growth and hold geographies. Periodic recalibration of underwriting models and use of analytics in collections saw our Zero DPD portfolio staying steadily above 80%

b) **Two wheeler:** The industry saw a major de-growth of ~20%. We focused on capturing higher counter share of chosen dealers and our disbursement growth remained flat while book grew by 41%. Like in Tractors, here too, we diversified our OEM mix, recalibrated our geographies and most importantly we have been continuously fine-tuning our credit scorecards, which has helped us increase our market share and maintain portfolio quality. We are already on our Gen4 scorecard and are currently testing our first behavioral scorecard. While we use analytics in all our businesses, Two wheeler is clearly way ahead in the use of analytics over other products. We believe that the technological edge that we have developed in this business will keep us differentiating in this market

c) **Micro Loans:** While our disbursements remained flat, book grew by 23%. And you will see a fair bit of disbursement growth over the first quarter, we had mentioned that we were going slow due to elections in the first quarter. And the run rate of about Rs. 900 Cr to Rs. 1,000 Cr per month we have brought back in the second quarter. We focused on underpenetrated geographies and underleveraged customers. Over leveraging of customers, according to us is a big risk factor developing and hence the ability to go deep using analytics and digital process flow for keeping expenses low is going to be the differentiating factor. Just as an illustration, we added about 5.8 lac new customers in the quarter, out of which about 40% were new to credit. We have also started new geographies like Punjab and Haryana and these will start contributing from Q3. So, just to reiterate this fact, 40% of our new acquisition in Micro Loans are new to credit. On-time collection ratio remains excellent at 99.4%. We have concentrated disproportionate energy on further reducing operational risk in this business and are making the model increasingly robust

While this monsoon is overall considered positive, there are nuisances – we have seen the century's driest June and wettest September and floods have caused difficulties in several areas; however it

has resulted in excellent reservoir and ground water levels in large parts of the country. Mood is overall upbeat and we are seeing a good demand on the field. While growth will pick up this festive season, it is unlikely to be in the positive area. So, while I am giving a positive indication in this festive season, and we are already seeing good movement from dealers, it is unlikely to be positive yoy as last festive season saw the best ever demand for tractors. So, it is unlikely that they will be positive this year. But having said that, Q3 will be far better than the monthly averages of H1. With a prospect of a delayed but good Kharif and a bumper Rabi, we expect FY21 to be excellent with all our base industries and the disbursements are expected to be positive in FY21. With the strengths, we have been constantly building on ground, we expect a pick-up in our disbursements in H2 and a positive momentum to be well and truly back in FY21. And we expect to further gain market share and disproportionately gain from this increase in demand in FY21

2. **Housing:** While the overall mood remains negative, we would like to point out some statistics. While residential sales have grown by 8%, new housing supply has fallen by 13%. Why the supply has fallen is because funding to Real Estate sector, etc. has slowed down. Inventory overhang has hence reduced from 43 months to 31 months. While the unsold stock in 6 major cities is still high, it has reduced by 19%. It is interesting to find that projects launched after January 2018 are showing better absorption. Obviously the reason seems to be that they are better structured projects, with smaller and lower ticket sizes. With reputed and strong builders taking over projects, there has been tremendous consolidation and the number of builders has actually reduced by half in the last 7-8 years or so. And if you take certain geographies, the number of builders has actually reduced by 80-85%. So, lots of consolidation has taken place with projects making it stronger
 - a) **Retail Home Loan:** Disbursements growth has been about 8% with majority of the disbursements being to salaried segment. In retail housing we continue to concentrate on getting our client mix and sourcing mix right. 74% of Home Loans is now sourced directly without any DSA
 - b) **LAP:** We continue to be very selective in LAP disbursements
 - c) **Real Estate:** As I have always said, we are very proud of our skills in terms of choice of projects Early Warning Signals and resolution mechanisms that we have built in the Real Estate financing business. Real Estate financing, is not a spectator sport, and you need to build differential skills to be able to do this business well. We recognise the elevated risks in the sector. While we believe that our parentage and knowledge gives us differential skills to handle this risk, we will continue to be very selective in Real Estate disbursements in the near future. In 97% of our projects, we are sole lenders and our focus will clearly be on completing these projects. We are closely monitoring each of our projects with the close involvement of our parent. Our Real Estate financing exposure is ~15-16% of our loan book and will continue to remain in that range maximum, we will not go beyond this. In all our construction finance cases, monthly interest is received from the project cash flows and principal prepayments have been received in 92 out of 114 projects, well ahead of schedule. There are lots of questions on moratorium, obviously every project in the construction period has to have repayments moratorium. The way we structure it is that interest has to be received on monthly basis and we also have early repayments or sweep-in mechanism from the escrow account. And as many as 92 projects out of 114 that we are doing, the remaining being in very early stage, and where the sweep-in has not yet started; 92 projects prepayments have actually started. In fact in the first half of FY20, ~Rs. 1,655 Cr have been received in form of prepayments and .repayments. That shows that the portfolio keeps churning. Last time somebody had asked questions about refinancing, and I said, 'In this market who is refinancing?' So, all the prepayments and repayments here are actual prepayments and repayments

3. **Infra Finance:** We continue to focus on Roads, Renewables and Transmission sectors. We continue to maintain our market leadership in our focused sectors with a strong pipeline. Even in a challenging market, we have registered a sell down volume of ~Rs. 1,700 Cr, indicating that the strength we have built in our underwriting and sell down capabilities. With IDF as the growth balance sheet and the Infrastructure finance company as the churn balance sheet we believe we have an excellent profitable business model. With an exit from structured finance, DCM, etc. we will be able to focus more on our key strengths in Infra Finance

There are lots of questions still going on about the Andhra portfolio, we confirm that our Andhra portfolio continues to be Zero DPD. The DSRA is still untouched, any working capital line is still untouched. This shows that the promoters are servicing the repayment obligations. The way it is done, of course by choice of promoters, number one, which I had briefed last time. Further, we have, a pooling mechanism in place, i.e. when a promoter with a large renewable platform is funded, we pool the extra receivables/cash from their other projects which we can use for repayments of any projects which may be in temporary difficulty. While we believe that Andhra solution will come pretty soon, at this point of time, there are still some question marks over it for the overall solution. However, our portfolio continues to be at Zero DPD and the quarterly/monthly payments continue to be received

Conclusion

With this, I will conclude and open for questions. We look at these results positively with conserving business strengths, gaining market share, 19% growth in core businesses, 6.9% NIMs+Fees, steady asset quality and ROE of 18% (adjusted 16.2%). Moreover, our capital adequacy stands almost at 19% and under I-GAAP at ~20%, and we believe that we have adequate equity capital to fund our growth. Reaffirmation of our AAA rating by 3 rating agencies and obtaining a new AAA rating from CRISIL coupled with our strong parentage puts us in an advantageous position for raising the required debt capital for further growth

Our model of staying liquid, strong underwriting, EWS and using our analytics ability to the hilt has helped us stay strong in this time. We believe that H2 is likely to be better than H1 in terms of demand for credit and growth may be back in many of our underlying sectors in FY21 and we will be ready to gain from it ahead of the competition with strong business and balance sheet strengths. We will all the while make sure that this growth remains healthy, i.e. it comes without sacrificing margins, opex and credit costs

I will stop here and wait for your questions to give you any further clarifications.

Moderator:

Thank you very much, sir. The first question is from the line of Kunal Shah from Edelweiss.

Kunal Shah

Congratulations sir for operationally good set of numbers. Firstly, in terms of asset quality, so broadly, when we look at across the segments, it seems stable apart from Rural. But if we just do the adjustments, it seems like in the de-focused business, it has gone up by almost Rs. 300 crore. So, is it like one or two couple of accounts? And if we are continuing to unwind this book, maybe out of the balance proportion which is there on Rs. 7,000-odd crore, do we see further stress buildup in this particular segment?

Dinanath Dubhashi:

We do not think so. Let me start with Rural. The billings in rural happen in June and December (wherever there is six-monthly billing), which corresponds with the cash cycle in Farm. And with the GS3 recognition now coming to 90 days, you remember that before it came to 90 days, the peaks used to be in December and June, now the peaks have moved to September and March. We have studied this increase very carefully

and I can confirm that it is only in Farm and not in Micro Loans and Two wheelers. And looking at the aging of the NPAs, it is very temporary and we are sticking our neck out by saying in December they will come back in control. So, that's as far as Rural is concerned.

You are right, that if you do the math, there will be one or two assets which have moved to GS3 in the defocused business. We do not see a huge deterioration there. As you have seen, we have been able to reduce the defocused book quite substantially. Of course, the speed of reduction will not be this dramatic in future. We are expecting this Rs. 7,200 Cr or so to come down to close to Rs. 5,000 crore by end of March, and that to continue. So, you are right about Rs. 300 crore increase in GS3, which is in fact just one account.

Kunal Shah:

Yes, but, just wanted to get a sense in terms of this Rs. 300 crore, how collateralized it is? And since we are running down the portfolio, how would be the recoverability of this Rs. 300-odd crore and what could be the anticipated haircut on this?

Dinanath Dubhashi:

I am not going to talk about any specific account or name on the call. But, we are a going concern, and every quarter provisions are taken on every account based on what we see as underlying recoverability. You would see uptick even in the credit cost, our credit costs have gone up to 2.5%. Normally, our credit costs are between 2% to 2.1%, this quarter credit costs are at 2.5%, which reflects the fairly large provisions taken in this particular account in the defocused business and qoq, as we reassess the recoverability of each account, we will continue to provide. Having said that, we do not expect any sudden shocks coming in this, though we continue to get surprised hits. There was another company which in spite of being 1.5x debt-equity ratio, defaulted a couple of months back. We have about Rs. 180 crore exposure to them. We expect things to get better there but other than these absolute one-off surprises we get, we are very much in control of the portfolio and have taken adequate provisions for that. I also talked about the wealth sale, and in Q3 we will book good amount of profits and will make specific or general provisions out of these profits, we will use to further strengthen our balance sheet. So, as far as provisions are concerned, we will be always very prudently and adequately provided

Kunal Shah:

Sure and given this kind of an environment, looking at our entire project developer book, no doubt there is enough of disclosure which provides the comfort in terms of 92 out of 114 that are prepaying. But are we drawing out any watch list or maybe some concerned accounts we are getting the provisioning and there will be a windfall gain in Q3 as well which will be utilized. But any quantum which we can see either on the Infra and the Real Estate book?

Dinanath Dubhashi:

In Real Estate we have Early Warning Signals, today we have formed a committee which has our senior people as well as L&T's very senior people, including the Head of Real Estate business. This committee is reviewed periodically, every once in a month by the Group CFO of L&T and myself. This committee looks at every account, whether it is regular, not regular, which stage, every account is reviewed in detail. There are templates, each account is reviewed, and for any early warning signal, early action is taken. And L&T is 100% involved, it's not just saying that when there is a problem L&T will come in, etc. L&T is totally involved in monitoring every Real Estate account

I do not know whether it will continue beyond a year, we acknowledge that this is the time that we have to be 200% sure that our portfolio is good, and this is our way of taking the bull by its horns. We look at every account and any early improvement which needs to be done like appointment of a strong selling agent or changing the contractor, bringing in some consultant from L&T to make sure that things go well, putting a

CFO or an audit firm to look at a certain escrow account if we believe that it needs to be looked at properly, we do that. From this level to either L&T taking over as DM or JDA or we bringing in some other developer of similar repute to get into DM or a JDA for the project. So, it's an overall plan. Last time I had talked about six or seven accounts which are more than zero DPD, which stay between say 1, 2 to about 70, 75 DPD, they largely continue to be the similar number. A couple of accounts have gone out of that, couple of accounts have come in. But as far as the overall amount is concerned, which is non-zero DPD, it continues to be same, in fact, it has reduced a bit

Kunal Shah:

Lastly, how many projects will be less than 70% constructed?

Dinanath Dubhashi:

I will get back to you on this, it's a very specific data

Moderator:

The next question is from the line of Karthik Chellappa from Buena Vista Fund Management

Karthik Chellappa:

Congrats on the good quarter. Just two questions from my side, one each on Two wheelers and Micro Loans. If I were to look at our Two Wheelers, relative to the fourth quarter, the ticket size has actually gone up from Rs. 52,000 to about Rs. 60,000. Whereas, there has not been any change in the average tenure. You spoke about mining the data a bit more, developing dealer relationships a bit more. But a 15% increase in average ticket size in two quarters looks a bit high. Any color on that?

Dinanath Dubhashi:

Number one, as you know, the price of Two wheelers itself has gone up drastically. If you take my overall portfolio, over the last two quarters that you mentioned, the average LTV has been around 75%. In fact to be exact, my average LTV was 74.5% two quarters back, and now it's 75.5%. So, it has increased by 1%, the LTV, which is also depending more on mix of products, models, etc., we do. There are certain models where there will be slightly higher LTV, certain models with lower LTV. Nowhere LTV has gone up drastically, so largely speaking, it is a function of price increase and LTV increase is for safer model and as we get more confidence in our credit model, however 90% of question can be answered because of price increase

Karthik Chellappa:

The second one on Micro loans, in the last quarter you had alluded to certain geographies where you are avoiding, let's say like West Bengal or so. Currently, are there any geographies which you have added to that list where you are a little more cautious either because of a temporary flood issue or over-leveraging or so?

Dinanath Dubhashi:

Okay. We are not avoiding, we have reduced. We do not do it state-wise. What I told last time, West Bengal, is just because many areas in that state was a problem because of political risk and analytics unfortunately can't capture that risk. The way we do is a very meeting center wise and then pin-code wise analysis of our portfolio as well as everybody else's portfolio. Now the good thing about Micro loans business, very counter intuitively, is that it is a business where the maximum data is available. Many people and many players do not like to say this because they still believe that it is bottom of the pyramid, feel good, CSR kind of business; we do not believe that at all. We do CSR separately. Micro Loans is a very commercial proposition and most importantly, it is one retail business where availability of data is just fantastic. And based on that we do very clearly the following: a good heuristic model on the total indebtedness of each person, how is that person's credit record in terms of payments, etc. And not only that, in case of a new to credit customer, creation of

look-alikes - that is how credit is done. We do not go into classifying states as high risk, low risk generally, unless we see a political overtone in that.

To answer your question, we are not seeing any huge political undertone or overtone in any other state. In fact, even West Bengal has gone a little quiet there as far as politics is concerned. Having said that, over the last one year we have reduced the proportion of West Bengal from 10% to 7%, proportion of Odisha has come down from 14% to 6%. So, Odisha largely has come down because of over-leveraging in that area. These are two very specific states that we have reduced. And additions have happened in new states like Jharkhand, Chhattisgarh, Bihar, that's where the proportion to book has actually gone up. And Odisha and West Bengal have come down. As I said in my opening remarks, Punjab and Haryana is where we have set the network already, we have not yet done disbursements there, we will start disbursements in the third quarter. Our method is, we put the entire network, the leadership, collection teams, RCU audit teams in a particular state, and only then we start business there. So, Punjab and Haryana will see a good addition

Based on this, our renewal percentage is abysmal at ~25%. With so much data that we get about over-lending or over-leveraging of our customers, actually, 75% of our own customers we reject. We are looking at certain schemes where we can approach these customers early and do a top-up maybe in the midterm where they are still under leveraged. So, that is a scheme we are putting in place. We are going deeper and looking at more new to credit customers. 40% of new acquisitions have been new to credit. I think this is a very important statistic. So, this way we try and manage the risk. As far as floods are concerned, yes, flood-affected areas there was a temporary drop in collection efficiencies. I can confirm that in October, again, the collection efficiencies have caught up and we are back at regular collection efficiency close to 99.4%

Karthik Chellappa:

Perfect. Thanks a lot for the detailed explanation. Just one follow-up. If I were to look at our Micro book again, our disbursements were up 2%, whereas our AUM is up 23%. Or to put it in another way, in the second quarter of last year, if I take that disbursement amount of about Rs. 2,800-odd crore and annualize it, it comes to more or less our AUM, which means it's a 12-months cycle. But if I take the disbursement amount for the second quarter of this year, which is Rs. 2,839 crore, and annualize it, it's slightly lower than our outstanding AUM. And given that you mentioned that the repayment rate is still around 99.5%, does it mean the duration of the loans has been extended?

Dinanath Dubhashi:

I didn't understand fully, maybe we will meet you to understand the math. Our overall duration remains 24 months, it's not one year. One year was the case when the ticket sizes were really very low. Most of our loans are 24 months. They have been for 24 months at least for the last two years. Anuj will get back to you on math. But, the difference between disbursement growth and book growth is just the math coming out of a monthly amortizing product. And if disbursements remain at this level or a little less than this, the book growth will actually come down. So, our attempt will be to increase disbursements to more than Rs. 3,000 crore so that the book growth doesn't come down

Karthik Chellappa:

Just one additional data point, you mentioned that 40% incremental customers are new to credit. On an outstanding basis, what will that count be?

Dinanath Dubhashi:

I will give you that data, it's not there with me right now. We have 63 lacs customers and I assume you would like to know how many of them were new to credit when acquired

Moderator:

Thank you. The next question is from Umang Shah from HSBC Securities

Umang Shah:

Congratulations on a good quarter to your team. Just two questions, one is, clearly our ratings have been reaffirmed, and now that we have got CRISIL AAA, if I combine that with the fall of interest rates in the system, is it fair to expect that in the second half or maybe early first half next year, we should start seeing our cost of funds also coming down?

Dinanath Dubhashi:

I would hope so. But I will give you what we are conservatively guiding, and the mathematics behind that. And I hope that actually what turns out is better than what I am guiding. So, we are conservatively guiding that at the end of the year we may be at around 8.7%-8.75%. The reason is that, yes you are right that because of the AAA and especially the latest one we have got, our cost of funds in each of the categories or each of the sourcing should come down, there is no doubt about it. But you see how we have reduced CPs, number one. And if we maintain this 90% long-term, overall the weighted average is going to be higher than what was last year, when CPs were more than 16%-17%.

Second, we will go retail even more. In fact, we should do our next retail issue very soon. And as we go more retail, we would like to pay a little more for the retail customer vis-à-vis what are normally available for private placements. There is a cost of diversification, there is a cost of retailisation. It adds that much strength, it adds that much risk free dependability on the balance sheet on the liability side. There is one more factor, I will raise more PSL. So, because of that the fund cost will come down. So, it is a mix of all. We hope that we will be able to bring it down below this level. I am just conservatively guiding that it may be 10 bps lower than this. But definitely the rise, and even though that rise was also pretty modest, just 30 bps over the last one year, we are not going to see that kind of rise in the second half, surely

Umang Shah:

Okay. That's helpful. My second question is regarding the asset quality. So, I appreciate that you have said that you wouldn't want to talk about specific accounts. But let's say based on your assessment and based on some of the names that have been floating around, and some of the names which we have already discussed in the past, the names like Dewan, Supertech, and so on and so forth. Probably from next quarter onwards if you could just give us a very brief sort of a gist as to what is our exposure to these names cumulatively, not individually. And what we have already provided against all of these accounts, given the fact that we have already started to kind of build-up provisions against some of these names, maybe not all, that can also probably give us a little more comfort on the asset quality front

Dinanath Dubhashi:

Sure. A couple of ways I would like to react to this. Number one, there are three names that we have discussed in the past, and I will give you update on these three names:

1. **IL&FS:** You know that we had six projects, six SPVs. One of them, which was a small one, is fully repaid, so now we have five. Out of five, four are now green. So, out of our ~Rs. 1,700 Cr exposure, now about Rs. 1,600 Cr or so is green, so 94% is green. One, which is a small exposure, about Rs. 100 Cr still continues to be amber. And we are still working on that, but the most important thing to consider is 94% of IL&FS exposure is now green. Now for those green projects as well as these amber projects, bids have been received by IL&FS for the sale. And we believe that those bids are more than adequate to get the payments of the secured creditors fully. So, according to me, IL&FS, we are through. It might take a couple of months more or maybe even this year, but we should be okay in IL&FS
2. **Supertech:** We have been updating pretty regularly on Supertech. I must admit that the sale velocity has come down from what it was before. The construction velocity continues. Our project, we are making sure that our projects continue being constructed and completed. Most importantly, I believe I have said this last time, that our Early Warning Signals help us to approach any developer before the market and

get additional securities from the developer as the particular project starts getting in some kind of difficulty. So, that way from Supertech as well, we have got quite a few adequate securities like a mall or a hotel, some land bank, etc. And using all this, I would not like to give too much details on the call, because all this becomes competitive information as well, because these term sheets some of them are signed, some of them are getting signed. But with this, by the end of the year, we believe that there will be substantial reduction in the exposure that we have. And when I say substantial, I mean really substantial, around 30%-40% reduction in the exposure that we have. And then we can see the same project with a 30%, 40% less outstanding, the strength of the project will just start looking very different

- 3. The housing finance company:** I do not believe I have given the name out, but obviously you can guess it. We have provided about 50%. Lots of developments are happening there. We believe that at this point of time the provision is adequate. In fact, the resolution plan which was given by the management and is being discussed, we may be able to write back some of the provisions, based on the resolution plan. Now, don't ask me about the other developments which are happening recently. But based on that resolution plan, we may be able to write back something after considering new developments. We are not in a hurry to write back anything yet. We will see how it goes. But we believe we are adequately provided on that

These are the three names I have talked about, so I am giving update on that. I would only request that, names are thrown about here and there, lots of data is also taken out from various registries. Most of the times the data is wrong. And it is wrong for a simple reason, I will give you one such reason, which is if two of my subsidiaries have created security for the same loan, that security is counted twice and hence, analysts reach a conclusion that our exposure is double than what it actually is. Secondly, anybody who has lent unsecured to that particular promoter, it will not reflect. Since, all our exposures are secured, and hence it gets reflected. Also, there is a difference between outstanding and sanctioned in the Registrar of Companies (filing), the sanctioned loan will show, whereas outstanding at any point of time will be much lower than that

And I would like to only end by saying that we will be very quick to recognize GS3, we will be very quick to provide, and most importantly, the Early Warning Signals will help us resolve many things. Either we can discuss asset-by-asset which I am definitely not going to discuss on a call, or we can look back that when ratings are being downgraded of NBFCs at a drop of a hat, I think everybody who has wholesale exposure or a Real Estate exposure has been practically downgraded. In this atmosphere, our ratings remaining AAA by all the three rating agencies that we were having before and then going ahead, why did we go to CRISIL. It's not as if we needed one more rating for raising money. We also went as a sort of certificate, we can't open our books to everyone, we can open to rating agencies, large banks who have ticket sizes of more than Rs. 5,000 Cr with us, and they have also gone through and sanctioned this kind of money. And last but not the least, institutions like IFC and AIIB. If they have gone through the book and after that given us a AAA rating or given us money, I would really take that at least on the public forum

Umang Shah:

Understand, this is quite helpful and just last question, have we already signed or are we exploring signing any co-origination agreements with any of the banks?

Dinanath Dubhashi:

Not yet. Because we believe at this point of time we are having enough and more liquidity to grow our retail book. As you would see, the retail disbursements at this point of time are negative. I would ideally like the retail disbursements to be much higher, and hence the retail book growth to be much higher. I want to do retailisation of my balance sheet at a faster pace. So, we do not see a reason at this point of time to do a co-origination agreement. It's not as if there is a category of retail which I am not finding money for or which I do not want to keep on my balance sheet. The capital adequacy is close to 20%. So, at this point of time, do not really see a case for doing it. Future, who knows, let's see

Moderator:

Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund

Amit Premchandani:

Sir, just a question on the housing side. There you have a net worth of around Rs.4,300 Cr. And if you even assign 25% of that networth to the retail and LAP part, the remaining net worth is around Rs.3,200 Cr. Against that, you have Rs. 15,000 Cr to Rs. 16,000 Cr of developer exposure. So, are rating agencies comfortable with 5x to 6x leverage of a developer book?

Dinanath Dubhashi:

Rating agencies do not look at how much leverage is to each kind of book, number one. Number two is, the rating agencies will go through each of the account, will see the behavior of each of the account, will see its behaviour how money is coming back in each of the account and give ratings accordingly. So, to answer your question, I do not think that for a particular book what is the kind of leverage or capital adequacy, that people have had a look at. They have looked at housing finance, there is the HFC subsidiary, and the overall leverage is 5.71. And yes, as you say, if for retail, you take the leverage to 8 or 9, well, on the Real Estate the leverage will work out to be much, much lower. And to answer your question, whether they are comfortable - We have got the highest rating, right? So, I guess, they are comfortable

Amit Premchandani:

Sir, among the projects that you have funded on the Real Estate side, how many have seen stoppage in construction?

Dinanath Dubhashi:

Stoppage? No, zero. We will not allow any stoppage in construction

Amit Premchandani:

And of this Rs. 15,000 Cr - Rs. 16,000 Cr exposure, what percentage is, say, LRD, mall, etc.? And what percentage is not completed projects or construction still continuing?

Dinanath Dubhashi:

Construction still continuing, especially in late stage will be a lot. I am not giving you very specific numbers here. Commercial, of the book is around 15% to 17%. Of new disbursement, commercial is around 66%. After a project is completed, typically, we should be getting back all of our money. So, if you see the portfolio, a large part of it will be under construction, because if the project is completed, and we have not got all the money till now, we should move in, look at it as an early warning signal and appoint a strong selling agent, get it sold and get our money back, etc.

Amit Premchandani:

And sir, how much of the project is exposed to Lower Parel?

Dinanath Dubhashi:

Zero. Lower Parel, zero. I am giving you lots of answers on the call, but, yes, that's off-the-top answer. Obviously, you have lots of questions for Real Estate. Contact Anuj, without giving you specific numbers, he will give you some color on the portfolio. See it like this, right, Real Estate today is a sector that either you can see ghosts everywhere. You should see risk, we are also seeing risk. You have to be very, very careful in everything that you do in Real Estate

At the same time, you can't see ghosts everywhere. There are buildings getting completed, irrespective of what people believe. There are apartments getting sold. The point is, there are certain developers whose buildings that are getting completed, and there are certain type of apartments which are getting sold. I mean, why anyone else, you take the best of developers, you will see the four and five bedrooms going really extremely slowly and the one and two bedrooms flying off the shelf. And this is primary data. Our group is in this business, right, both for development as well as in construction and this is primary data. I can't be more specific on the call, but we have data project-wise at least in the large cities. I can tell you this that there are projects which are moving, and there are projects where sales are not moving. It's important that how you have chosen the projects, how you make sure that you are sole financiers, so projects do not stop for the lack of money - 97% we are sole financiers, the remaining 3% we are with the largest HFC in the country

So, we do not see any issue of projects stopping because of lack of funds. But any other reason of projects stopping, we will not let it happen. There are cases where, say, for example, a couple of projects, a particular construction company, constructor and not developer, came in trouble. We got it replaced in a jiffy. That's the capability that we have because of L&T and we can get it done. We got the contractor replaced and construction started at full swing. So, just to make a point, either we can see ghosts everywhere or you can actually crystallize risk, what are promoter risks, what are project risks, what are funding risks, etc., what are approval risks, and work on each one of them and make sure that your portfolio remains healthy

Moderator:

Thank you. The next question is from the line of Yash Gupta from Prince Poly Plast

Yash Gupta:

Congrats on good set of numbers. Our fees and other income has shown a growth of around to be 18.5% quarter-on-quarter, and this is the highest growth in the last eight quarters. Can you please explain what drives this growth and what's your outlook for this for the next one year?

Dinanath Dubhashi:

We concentrate on many things, so let me just take you back in past. We started this push on fees three years back, and largely that time fees used to come from wholesale, which was from underwriting fees, advisory fees, and then getting the advisory fees on 100% and then selling down around 70%-80% of the exposure, and thus keeping the fees. After that, the retail businesses started catching up and we have done extremely well, especially in retail in cross-sell. So, number one, we have a principle in retail, that our processing fees, basically the processing or application fee that we take from our customers, will always been net positive. Net positive meaning that, the money that we spend in dealers' payouts or doing any FI or legal checks on the ground, will always be less than the processing fee that we get. So, we always have a net positive processing fee. That is number one

And then as we got into strong data analytics, we increased our cross-selling tremendously. Just one year back if I used to sell about 1.8 products to each of my customer, today that number is close to 3, or it's about ~2.8 to be precise. And these are basically protection products, insurance products. Initially, we used to do only credit life, we have moved to now doing life insurance, we are doing critical illness, we are doing roadside assistance. So, many things which actually helps the customer as well as earns us fees, we are doing it

Basically that is leading to this, a virtuous cycle where our overall fees actually pays for our opex. And I think we could take pride in that. I believe if it's not only one of, maybe a couple of NBFCs, where fees pay totally for opex and we will continue to be it in this range. However, having said that, our guidance is always for NIMs+Fees. Because guiding on just fees quarter-on-quarter is a very risky business. I consider my word to

be very important. All of you have shown the trust in my word. But NIMs plus fees, we will definitely be able to guide. We will always maintain it, we will never be below 6.5% and would like to maintain it from 6.5% to 7%. And which leads, if you just calculate, go down the ROE tree, it will take us to around 2.2%-2.3% ROA and around 16%-16.5% ROE

Yash Gupta:

Secondly sir, what's your assessment on the liquidity side? Any liquidity went to the market after the action taken by the FM? And is there any improvement the availability of loan for the customer?

Dinanath Dubhashi:

Okay. Let us not try and connect the effect of each one of our announcements on what is happening in the market. This doesn't work, it's never like that. Is liquidity today way, way better than what it was nine-months back? Yes, certainly, there is no doubt about that. Not only liquidity in the system, even liquidity available in the market is way better than what it was nine-months back, there is no doubt about it. But there are some nuances in this. There is a lot of flight-to-safety first of all. So, let's say, if x number of NBFCs and I am first talking about sources of funds for NBFCs, and then I will talk about NBFC disbursements for the clients. And spare me for a long answer because this is very important factor

Number one, within NBFCs if x number of NBFCs were getting money, today it's maybe x/4 or 25% which are getting money. That is number one. Number two, overall bank funding will be limited, especially to large NBFC's belonging to large Groups till these Group limits, are clarified by RBI. Till then, there will be limits on how much an L&T Group or any other group will be able to borrow. That is number two

The biggest issue in NBFC liquidity today is Mutual Funds, who used to be the main source of NCDs, they are themselves getting less amount of money in their long-term credit funds, number one. And number two, the limits of NBFCs there, which the SEBI has set, has also come down. Now what does it mean? While the overall money available to NBFC's is coming down, there is a flight-to-safety that is number one. Number two, good NBFCs with good parentage, with good ratings, will go and look at diversifying so that we de-risk ourselves from any blips in liquidity. So, diversification can be in form of retail, foreign funds, we have already raised ECBs. There is an article today that, newspapers seem to know before us that we have plans for foreign bonds, etc. Surely we have plan, now that have got the highest domestic ratings from all agencies, we will now move our international rating and raise foreign bonds. Doing all this, there is certainly no dearth of liquidity for good NBFCs. And I am not talking only about ourselves. Definitely, all good AAA NBFCs with good parentage are getting money

Now where are we lending? And there I will talk about ourselves. So, number one, any retail business, whether it is retail housing or rural businesses or any new retail business that we will launch. By the way, we have just piloted our personal loans business mainly on loyalty, i.e. on our own database, done lot of analytics on our own database and selling personal loans to them. But I will talk more about it in next quarter, at that time I will be having the thunder to talk about it. But any retail product, there is no dearth of liquidity. It's not that money is not there so retail loans will be stopped, there is no question about that. Number two, Real Estate, we are anyway being very selective. As we have said, our overall risk limit on Real Estate to total book is 17.5% to total book. We are already at about 15.5%. So, we are going to be very, very selective in Real Estate business, because largely we will concentrate on completing our own projects. So, that's as far as Real Estate is concerned

Infra, we will be very selective. We are only in about three areas of Infra, and we will be very selective in the disbursement, we always have been. Infra book has actually grown as the funded sell-down has been little. Our overall sell-down has been very good, but the funded sell-down is little lower. So, that completes my

entire focused book. Also, for us is this rapid reduction in the defocused book is also making money available for the focused book to grow

The conclusion is that I do not think that, we have passed the time that any disbursement that we want to do we will not be able to do because of money not being available. Disbursement did not happen because either demand was less or we saw that risks were high. So, those will be the reasons, not lack of money

Moderator:

Thank you. We take the last question from the line of Anitha Rangan from HSBC Asset Management.

Anitha Rangan:

One thing I just wanted to understand was that, post this Dewan's one of the securitized papers actually defaulting, are you going to see any difficulty overall in securitizing instruments as a whole? Are you seeing that already or do you see any challenge going forward?

Dinanath Dubhashi:

So, for us, it is easy, we have zero securitisation, practically zero. There are some things that we have securitized 2-3 years back just to try out our hand in the market. I have given this answer in terms of co-sourcing some time back that I want to grow my retail book rapidly. I do not see availability of money as a constraint for that. I am not saying that I will never do securitization, I am only saying that in the near-term there is less incentive for us to do securitization. We were actually looking at securitizing some of our PSL portfolio when RBI gave this permission for on-lending. Now money is available while keeping our PSL portfolio on our books. So, it doesn't affect us really. How the market will develop, I don't think I want to comment. But I believe that the time that you just buy a securitized paper and then forget about it, people may be little more watchful on the asset quality, on the quality of the sourcing company and may also look at portfolio locations, etc.

I will tell you, this particular HFC where we have bonds, before this whole thing became a national issue, we were also looking at buying certain retail assets from that HFC; long-time back. It didn't happen. But the way we were looking at is not securitized paper but actually taking over portfolio. And hence we were looking at a good portfolio and the portfolio in locations that we can service. I think, more and more, the buyer of the security will start looking at the serviceability of this portfolio if something goes wrong with the originator. That may be slow changes happening in the market. It doesn't affect us at this point of time or in the near future

Anitha Rangan:

Okay. Thank you. I had a couple of more questions. So, my second question is on the liquidity side. I just wanted to understand, in the slide where you have given about ALM, comparing Q1 and Q2, which is now your overall re-priceable assets is almost the same and slightly come down. But your cumulative positive gap has increased substantially from Rs. 15,000 to Rs. 22,000. So, how does that work? Or has your assumptions overall changed, can you give me some color on that?

Dinanath Dubhashi:

Okay, you are comparing it with Q1. No assumptions have changed. Somebody will explain this to you offline. These are standard slides here. Right from September 21st, 2018, we have kept the same slide, only numbers have changed

Anitha Rangan:

Okay. And just one last question. You also spoke about L&T's involvement being very strong, which is also very good to know. Is this like some thought process which has changed with L&T and with yourself that you

are getting involved together as a company? Because in the past, I feel I was understanding that you work very independently and so on, so just wanted to understand that perspective also

Dinanath Dubhashi:

Yes, absolutely. I mean, we have a strong parent. Let me tell you, my daughter is a very independent young lady, which she manages everything on her own. But when she requires my help, I am always available, right? So, this is the time that we require our parent's help. And that's what the meaning of the parent is, meaning of a Group is. Normally speaking, not only this company, any subsidiary, any division of L&T will normally work independently. But in situations where specific attention is required. Because we always talk about Group strengths, there are times when the Group strength has to come on the field. And today, it helps in raising money, it helps in resolving assets, it helps in developing more monitoring metrics on the ground. And I can tell you one thing, we are very proud, independent professionals. But at this point of time, extremely thankful and grateful that we have a parent like L&T

Moderator:

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

Dinanath Dubhashi:

I think I have concluded already. We are very happy with the Q2 results. Look to H2 and especially FY21 with renewed hope, not only just hope but our findings on the ground also indicate towards good growth, higher disbursements, good profitability, balance sheet strength and most importantly the business strengths that we have continued to invest in through bad times. And this is where good companies get differentiated from others. Throughout these bad times we have not stopped investing in our strengths, which is network, analytics, digital even for 1 day. We have invested increased amount of money throughout this, and we are sure that as disbursement growth catches up, we will gain disproportionately from that

So, with this renewed hope and renewed positivity, let me wish all of you a very Happy Diwali, a very, very Happy New Year. Hopefully, this festive season will shake off all the negativity which seems to be fashionable now, not only in the sector but also in the country. Let Goddess Lakshmi be with all of you

Thank you