



L&T Finance Holdings

Q3 FY20 Earnings Call Transcript

January 20, 2020

Moderator:

Ladies and gentlemen, good day. And welcome to L&T Finance Holdings Q3 FY20 Earnings Conference Call. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo:

Thank you, Janice. Good morning, everyone. And thank you for joining us for L&T Finance Holdings Q3 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 maybe forward-looking nature. And a note to that effect is provided in the Q3 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, and welcome to all of you. And maybe a little late, but wish you all a very Happy New Year.

It gives me great pleasure to report another quarter of good results for LTFH. We will view the past calendar year with a lot of humility and gratitude. It was a difficult year, no doubt and the difficult conditions in the overall economy in general and the NBFC sector in particular, gave us the opportunity to test our resilience and the robustness of our business model and principles. We definitely had to do some heavy lifting and believe that we have come out much stronger at the end of the year. Our competitive strengths in our core businesses, ability to run down our defocused portfolio efficiently, ability to maintain margins and fees in difficult conditions, ability to raise adequate liabilities from diverse sources at the right cost, our early warning signals and project management capabilities, our assets resolution capabilities, our portfolio quality and last but not the least our execution abilities and group synergies have been adequately tested and have crystallised in form of good and steady financial performance.

Let me now make 2 or 3 important observations about this quarter's results before diving into business wise comments and then opening it up for questions.



1. First of all, we would view these results as one more quarter of delivering steady performance in line with our strategy of delivering assurance to all stakeholders. In the quest to deliver steady performance quarter after quarter, it is particularly important to do so especially in turbulent times and I believe that our performance for the last 4-5 quarters demonstrates that.

We generated a steady 'NIMs+Fee' of 7.29% in this quarter and the PPOP stood at Rs. 1,334 Cr, up by 12% on YoY basis. This sustainability is achieved on back of a data analytics-based approach which has helped us to increase/maintain market share while maintaining asset quality. The asset quality remained stable with GS3 at 5.94% vs 5.98% last quarter and NS3 at 2.67% vs 2.83% last quarter with provision coverage going up since last quarter. Steady margins, steady credit costs and asset quality has enabled us to deliver once again a top quartile ROE of 16.51%. PAT for the quarter stood at Rs. 591 Cr keeping its steady trajectory. It must be explained that the PAT for Q2 FY20 included a tax benefit of lower tax rates for Q1 and Q2 together and this number after normalisation is Rs 597 Cr. The profit trajectory is quite steady, the RoE was also 16.74% adjusted for this tax effect. So, both PAT and RoE have maintained a steady trajectory.

2. The second important point I would like to make is about the demarcation which is being seen between sound NBFCs and others - regarding raising of liabilities. This has, become clearer and more pronounced in Q3 FY20. Highly rated NBFCs with good parentage were clearly preferred over others by lenders of all genres.

As a result, one of the major positives of the quarter, not surprisingly, came from liabilities side. LTFH raised ~Rs. 10,400 Cr in long term borrowing in the quarter, the highest ever since FY17. As I have said before, the market is clearly differentiating NBFCs with high ratings & inherent parentage strengths and any concerns about availability of funds continue to subside with each quarter. LTFH successfully raised long term funds from diversified sources, may it be traditional sources of bank borrowings or privately placed NCDs or newer sources like public NCDs, ECBs and priority sector borrowings. We raised Rs. 1,408 Cr through Retail NCDs and Rs. 2,012 Cr through privately placed NCDs in this quarter. In addition to these, and taking advantage of RBI's on-lending PSL norms, we raised an additional Rs 1,818 Cr during the quarter. The proportion of CPs has reduced from 16% to 9% in the past year giving us a good dry powder for raising it by 1% to 2% going forward because the ALM comfortably allows for that. More importantly, despite an increase in proportion of long-term funds in liability mix and diversification in funding sources, WAC continues to remain stable at 8.54%. In fact it has reduced by 7 bps sequentially. Liquidity in all buckets up to one year continues to be positive and we are very comfortable in terms of cash in hand for funding a good disbursement pipeline we have in Q4.

3. The third point I would like to make is about growth. Our focused lending book for Q3 FY20 saw a growth of 14% on YoY basis. For individual platforms viz. Rural, Housing and Infra Finance segments, growth has been in the range of 13% to 14%. In line with our strategy, we've continued to rapidly rundown our defocused book, which stands at Rs 5,497 Cr at the end of this quarter. This represents a reduction of 55% on YoY basis & 24% on QoQ basis and this attests our ability to quickly rundown businesses which we have identified as defocused, without significant P&L impacts. So, the overall book growth of 5% has to be taken in that context, that it is a weighted average of about 14% growth in focused businesses, and a 55% reduction in defocused business.

As far as disbursement growth is concerned, our strategy always has been to maintain or improve our market share in our core businesses. Degrow less than the market in bad times and try and outgrow the market in good times, while keeping our risk and return parameters tight and robust, has been our continuous endeavour. We believe that any runaway growth in disbursements when the market is degrowing is likely to be toxic and we will always refrain from doing so. Just as an example, as the tractor market showed early signs of turnaround, we were able to register our best ever disbursements, while in all other products we were happy to maintain market share or even moderate our disbursements where we saw reasons to pull back temporarily. Our strategy will be to



keep investing in our strengths, new products, digital and data analytics, network which will enable us to grow better than market when the growth comes back.

New product launch: On the topic of new products, it is my pleasure to share with you that LTFH has initiated a pilot of its consumer loan business in the last quarter. The business launch is a testimony to our data analytics and cross-sell ability using the deep database we have of 2+ Cr customers. As a part of the pilot launch, we've disbursed to over 3,700 customers in Q3 FY20. The pricing to the customer is based on complete risk profiling of the customer, his ability to pay and competition mapping. The product is a 100% paperless, totally digital proposition for our customers entailing ease, low opex and hopefully, low credit costs as we go ahead. The book and the disbursement admittedly have been modest at about Rs. 40 Cr and we are confident of much better volumes in Q4 as far as this product is concerned.

Let me now take you through the highlights of individual businesses.

1. Rural:

The big positive is tractors, our Farm business

- a) Farm: The late rains in September, even October in some areas, resulted in healthy water reservoir and ground water levels leading to early signs of revival in select rural belts. We are seeing a delayed but decent Kharif crop, and the prospects of excellent Rabi crop are very, very good. Overall, the wholesale tractor market, and when I say wholesale, it is the number reported by the manufacturers - the wholesale tractor market saw a decline of 6% in Q3 on YoY basis, which is much lower than the double digit declines in previous quarters. This decline in wholesale numbers, viewed with the context of reduction in inventory overstocking translates to a flat retail consumption in Q3. A flat retail growth in this quarter, given a large base of Q3 FY19 and given the negative retail growth in the previous quarter is very impressive. Even though the pace of tractor sales reduced in December after an impressive festive season, we continue to predict a positive growth in the market in FY21. We believe that it is the first sign of green shoots in the tractor market. And FY21 we are quite sure is going to be a positive growth year. The farm equipment disbursements for LTFS in Q3 FY20 were highest ever, where we achieved a disbursement growth of 6% YOY and you will recollect that in the last festive season we had seen the largest disbursements then - over that it was 6% more. Equally impressive was our highest ever CD collection of 91% in Dec-19. We believe that, yes, market is improving, plus, I think our concentrated collection efforts based on data analytics is showing continuously improving results which led to reduction of NPA from Rs. 462 Cr in Q3 FY19 and Rs 382 Cr in Q2 FY20 to Rs. 342 Cr in Q3 FY20. You will remember that in Q2, I had indicated that farm GS3 increase is temporary and it will reduce in Q3. And excellent collections has led not only to good NPA levels, but very good collections in early bucket, which bodes extremely well for the portfolio as we go ahead. We owe our good disbursements to our strategy of doubling down on counter shares with dealers which our data analytics throws up as good and also to the success of our refinance/old tractors product which now constitutes 14% of total disbursements. Our average LTV continues to remain at 70%. This along with extensive use of data analytics for collections has helped us keep an excellent portfolio quality and we are very confident of maintaining this in the future as well.
- b) Two-wheeler: The momentum gained by two-wheeler industry in the festive season which was in October, with both Dusshera and Diwali falling in October, failed to sustain over the remaining part of the quarter. The last quarter saw a market decline of 13% in volume terms. Retail demand in Q4 is expected to be driven by inventory clearances due to cost differentials between BSIV and BSVI. LTFS achieved the highest ever monthly disbursements in October 2019, backed by festive demand and we maintained our market share during the quarter. The book grew by 23% on YoY basis. We're taking conscious calls on enhancing the business quality in this sector – primarily by maintaining LTVs at about 75% in a very competitive market and identifying the right matrix for OEM, geography & dealer classification using data analytics.



- c) Micro Loans: In micro loans we follow the strategy of moderating our disbursements in areas where we see increasing association of borrowers to multiple lenders, increasing total indebtedness and delays in payment to the industry as whole. In fact these rules are hard coded in the credit matrix and the number of credit rejects pin code wise provides us with our early warning signals. On the other hand growth comes from areas where the penetration of finance and hence leverage of customers is relatively lower, and we will continue to grow like this in the future. As a part of this strategy, we have launched operations in Punjab and Haryana in Q3. Disbursement have obviously been modest in Punjab and Haryana, it was just launched in Q3. We expect good volumes for that as we go ahead. Overall in Q3 micro loans disbursements degrew by 8% while book grew by 11%

For the overall Rural business, higher mandi prices of Kharif crops & significantly improved Rabi sowing signal gains for farmers & rural India in Q4 FY20 versus the previous nine months. We're able to see early green shoots of rural recovery with a pick-up in rural consumption. Sales of tractors are seen at -7% to -9% in H2 FY20 versus -12% in H1 FY20. Reservoir levels, our analytics shows that this is the single most important factor pushing sentiment and demand, are 41% better than long term averages and we see strong signs of revival in the rural market in FY21 and believe that with the strengths we have built, LTFH is in a strong position to benefit from this.

2. Housing:

- a) Home Loan and LAP: Some uptick in housing sector has been seen and it is concentrated around mid & affordable housing segment. We have seen a number of projects in mid and affordable, I am not saying affordable as in the Government scheme affordable, but yes, low and mid income housing segment, we have seen good sales after launch. Major players have started focusing in this segment. The new project launches have dropped by ~60% since H1 FY15 and 40% since H2 FY19, majorly due to focus of the industry on completion of ongoing projects and lack of liquidity for new project approvals.

LTFS showcased a disbursement growth of 8% in Home Loan segment with salaried segment growing by 31% in line with our strategy. The overall share of salaried customers grew from 51% to 62% on YoY basis. Direct sourcing contributed to ~70% of Home Loan cases in Q3 FY20. We continue to maintain a tight credit policy for LAP segment leading to a conservative disbursement approach. The average LTV of our LAP portfolio remains around 54%.

- b) Real Estate: While difficulties in the real estate sector continue, it showed reduction in inventory overhang to ~32 months from peak of ~45 months 2 years back. Excluding stuck projects, inventory overhang is 25 months. There is a higher preference for ready units, having even lower inventory overhang of 17 months. Now, 17 months as such for ready units is high, but some other figures quoted ~45 months etc., so 17 months for ready units is reasonably less than this. Projects launched since January 2018, with a higher share of Cat A developers, have seen 30% to 40% of project sales since January 2018. LTFS has continued disbursements to existing projects with focus on project completion. 97% of our projects, we are the sole financier and are confident of completing, selling and getting out of these projects. As I have always said, our group synergy places us in a very advantageous position for project and client selection, project monitoring and most importantly project completion and resolution if the project faces any issues. I have detailed it out earlier on how we are going about it, how we have formed a committee along with L&T Realty and how we are working absolutely hands-on project by project wherever it is required, with L&T Group. The current scenario has also opened up an opportunity for us to lend to the best of the best of developers. In the market, commercial absorption has seen steady growth over last 5 years and we are also increasing our share of commercial projects. Over the last one year in our portfolio, the weightage of commercial has increased from 6% to 17%. Definitely, Real-Estate, continues to be high risk at this point of time as the sector as a whole but we believe, given our portfolio, we are really in control of the projects, we have the confidence of completing and selling it.



3. Infrastructure finance:

The government has recently unveiled the plan, under the National Infrastructure Pipeline, of Rs. 102 lakh Cr for an enhanced push on infrastructure sector. These include projects of Rs. 42.7 lakh Cr which are already under implementation. The pipeline has allocated Rs. 29 lakh Cr for renewable energy and road sector, two of the focus areas for LTFS. In solar itself, 7.4 GW capacities have been allotted in the first 9 months till FY20, implying uptick in solar capacity additions. Open competitive bidding has yielded higher tariffs going up to Rs 3.29 per unit in UP. It varies between ~Rs. 2.6 in Rajasthan to Rs. 3.29 in UP. But generally they have seen an upward trend from the Rs. 2.43 low point which was seen. AP state discoms have already cleared dues up to June 19 at Rs 2.44 and have further committed to clear dues till sept 19. NTPC may buy 300 MW of RE power from AP further helping the resolution. Details of this scheme are awaited.

We continue to maintain our market leadership position in the identified sector with a strong pipeline in place for Q4 FY20. Our portfolio continues to perform excellently with Nil stage 3 in our focus areas on projects underwritten in the last 7-8 years.

4. Mutual Fund:

Despite the recent volatility in the market, our mutual fund business continues to grow and deliver and generate steady profits. The average AUM for Q3 stands at little more than Rs. 71,500 crore, which is up above 4% Y-o-Y basis. We command equity market share of about 3.6%, with the equity AUM at 57% of the total AUM. More importantly, against an industry average of 53%, our mutual fund business has a higher proportion of individual customer share, i.e. non-corporate share, in AUM of 66%. This has helped us in creating a long-term stable customer base, which has contributed to higher AUM growth and better profitability.

Conclusion

I'll summarize the results in a few lines and then answer the questions. True to our commitment of assurance, like the last 5 quarters, LTFH remains on the path of consistent financial performance through steady profit margins, stable asset quality and growth in focused businesses. We have delivered a top quartile RoE at 16.51%, a strong NIM+Fees and a reduction in GS3 to 5.94%. Our CRAR now stands over 20% giving us enough firepower to fuel growth when the tide turns. We've demonstrated the ability to raise liability in the right quantum and at the right price, which is the markets testimony to the strength of our business model, balance sheet, parentage and rating.

Steadiness is the hallmark of companies which exist in the market for perpetuity. Backed by strong data-analytics based approach, we continue to build strengths in our focused businesses and deliver steady performance QoQ.

The overall market growth for FY20 may remain negative, majorly on account of the growth slowdown in H1 of the financial year. However, we expect FY21 to be much better based on all the factors outlined by me till now, and on a lower base for FY20. We will continue to invest in our strengths and backed by a strong capital structure and liquidity we will be in a position to grow faster than the market when growth returns.

I thank you all for your patient listening and open the floor to questions.

Moderator:

The first question is from the line of Piran Engineer from Motilal Oswal Securities.



Piran Engineer:

Hi sir, congrats on the quarter. Couple of questions Sir. Firstly, when you mentioned that your share of commercial in Real estate is 17%, so is that lease rental discounting or commercial construction finance?

Dinanath Dubhashi:

Mostly commercial construction finance.

Piran Engineer:

Okay. And that happens at higher yields than residential or lower, generally?

Dinanath Dubhashi:

Nothing like that. Perhaps, if you take on an average, may be a little lower. It is not just commercial vs residence, now disbursement is done for absolute top of the line developers only. So, the disbursement that you see this quarter, ~50% is for our existing projects to complete and remaining 50% is for new. And those are entirely to absolute top of the class developers. That itself will see yields coming down a little bit.

Piran Engineer:

Okay, And in terms of your liquidity on the balance sheet, I have noticed that generally you are at Rs. 3,000 Cr - Rs. 3,500 Cr, but this time it's gone up to Rs. 7,000 Cr. I am not counting the un-availed bank sanctions and the credit line from L&T, just the actual cash on the balance sheet has gone up quite a bit. Is there something to read into it or is this just a one-off quarter?

Dinanath Dubhashi:

You are absolutely right, that Rs. 3,500 Cr to Rs. 4,000 Cr is a good level, 7% of balance sheet is not a good level. Two things happened. There was one large disbursement in one of the business, in infra actually, which didn't happen on the last day of the year, so that will show in Q4. That is number one. Number two is the PSL. These are very specific-purpose lines. They are drawn and then we have to wait for the tractor disbursement to happen. So, as we draw lines at the end of the quarter, it will be used all in Q4. The message I would like to give, is that, one - we have adequate liquidity and two, decent disbursement should be seen in Q4 with that liquidity.

Piran Engineer:

Okay and just last question. You mentioned that reservoir levels are up 41%, is that like pan-India or particular geographies?

Dinanath Dubhashi:

They are up pan-India, definitely. But certain geographies they are better than others.

Piran Engineer:

So 41% is for specific geographies?

Dinanath Dubhashi:

No, 41% is a pan-India average. And in specific geographies it is even higher.



Moderator:

Next question is from the line of Kunal Shah from Edelweiss.

Kunal Shah:

Congratulations for good set of numbers. Couple of questions Sir, firstly, if I look at the entire network, I think almost Rs. 1,000-odd crore have been allocated to infra segment, ballpark. So just want to get the sense, maybe the focused businesses would still be more of rural and housing, but incremental in net worth is flowing into infra. So what's the thought process behind it? And in fact, it's a relatively lower ROE generating business where net worth is going, so how should we look at it? So that was the first question.

Dinanath Dubhashi:

You are absolutely right that we will put net worth in the long-term, based on ROE, based on what is focus, etc. But let me reiterate that our focus is on all three businesses: Infra, Housing and Rural. The retailisation is also a drive which is for the long-term. We are seeing excellent disbursement pipeline in Infra at this point of time. And accordingly, we thought that reducing the leverage of the Infra entity is a good measure for the next one year.

There is another thing happening, as you would have seen, our sell down has been good this quarter though obviously it is not as good as what it used to be before. And we will have to maybe temporarily support the excellent Infra pipeline with the balance sheet equity has been put now, which will be used well over the next one year. You would also see that we have got into another area in infra, which is sort of a retail infra to say.

We have mentioned one line in our business presentation, it is City Gas Distribution (CGD). We have done our first two sanctions there. Excellent business, we will talk in detail about that based on your interest one to one. But in short, this is where private sector gets a particular district allocated, like a Mahanagar Gas in Mumbai, or Indraprastha gas in Delhi. They have eight years of monopoly, and even after that any player coming will have to use and pay for their network. As the money comes directly from retail user, either CNG or PNG, and we get access to that escrow account, it is very retail infra kind of a network. We are supporting that for players which are very good international players. So, all in all, we see good infra pipelines and the equity has been put there for maintaining a fairly low leverage, given the chunkiness of the book in that business.

Kunal Shah:

So, should we expect in terms of the disbursements in infra should be much better, maybe given the sanctions and things like that?

Dinanath Dubhashi:

I would say so, in immediate term, definitely. It is very difficult to predict, but in Q4 we will actually see a good growth in Infra disbursements. There is something which we could not do in Q3, some permission etc., was required. So Q3, the infra disbursements are very low, at Rs. 2,000 crore, part of it actually got postponed to Q4.

Kunal Shah:

Sure. Secondly, in terms of the overall rural segment. So MFI, maybe there is some bit of a lower disbursements and we are maybe going slow in a few geographies. So just want to understand which would that be? Is there any addition which is happening there besides the eastern and the northeastern? And what's the overall sense in terms of the Assam portfolio? So I think we have Rs. Rs.600-odd order crore, so how is the behavior of that and how we are doing vis-à-vis other players in this region?



Dinanath Dubhashi:

I will talk about myself so let's keep the overall growth, etc., aside. Any retail business, we don't aim for a particular growth and go there. That is the way we used to grow, like everybody else, maybe three years back. That, if the industry is growing by so much, I have to grow faster than this, etc. Now, every aspect of the growth comes from bottom up. Not bottom up based on what target branch gives, but what data analytics shows, especially since it is hard coded in the credit metrics. Which is how much business is possible to be done. Especially in microfinance the credit metrics itself starts throwing rejects. So, what are our credit metrics in microfinance - what are the total number of associations the person has, how much is the total indebtedness that the person has, and how is the delayed track record, forget default, but delay of the person with the whole industry (this data is available very regularly), hit rate with credit bureaus in microfinance. So, growth will depend on these- it is not like we aim for a particular growth and go for it. So that's very important. So the portfolio will always remain in control

I would like to talk about Assam in some detail, because we are looking at Assam as the certificate. Actually we are very happy that it is almost industry best, best-in-class early warning signals which are working. So let me give you some history, and I am going into little bit of detail. In Q3 of FY19 our book in Assam was Rs. 750 Cr, close to it. And our disbursement was ~Rs. 230 Cr a quarter. Assam was doing extremely well, very low delinquency, fairly low indebtedness. In Q4 of FY19, it was the first time I started talking about seeing something in Eastern India, Credit rejections in Assam, and there was no talk of any agitation. But this is how the hard coding in credit works for early defaults. So we would like to really put it in public space, because a lot of talks said about microfinance business is not done this way, it is the business of heart, etc. We don't believe so, we believe it is data bases business. So, I will just give you the case study.

In Q4 of FY19, our credit rejections increased by 40% over the previous quarter and increase in early warning signals of customers started coming. We immediately put nine meeting centers identified on rundown. And disbursements from Rs. 230 crore in Q3 automatically came to Rs. 166 crore in Q4. Further in Q1, credit rejections increased by further 20%. Now, this doesn't come in portfolio, these are credit rejections, so obviously they don't come in portfolio, but good early warning signals are read not out of our portfolio, because early warning signals that read out of our portfolios are not early anymore. So they have to read out of credit rejections. So as credit rejections increased by further 20%, we put even more Meeting Centers on rundown, and disbursements note it, came down to Rs. 87 crore in Q1 of FY20.

Similarly, Q2 of FY20 there were early floods in Assam, situation deteriorated a bit more. We reduced disbursements to Rs. 80 crore in Q2 and the portfolio, that is why kept coming down. Because if you know, the big issue in Assam actually happened about some agitations in Dibrugarh etc. in October. And anybody who reacted at that time, simple mathematics of amortization, if you had reacted in October, you can do nothing about your portfolio at this point of time. Okay? Very simple. So, that is how our peak portfolio exposure of Rs. 800 crore, came down to Rs. 600 crore because we could react early. The disbursements in Q3FY20 is down to about Rs. 34 crore from a peak of Rs. 213 crore, and that Rs. 34 crore is also happening in the best of areas, that is number one.

Number two, against industry's average ticket size of about Rs. 30,000, our average ticket size in Assam is Rs. 17,000. If you see, and this is data coming from Highmark etc., if you see various categories of loans which is < Rs. 20,000, Rs. 20,000 - Rs. 40,000, Rs. 40,000 - Rs. 60,000, >Rs. 60,000, almost 100% of our initial disbursement is in the Rs. 20,000 - Rs. 30,000 range, which is very different than the industry. The industry is way higher than that. And our average outstanding is in Rs. 17,000 range.

Last but not the least, as we had done in Orissa, and somebody will ask the question of increased credit cost. As we had done in Orissa exactly one year back, anything more than 31 days DPD in Assam, we have taken aggressive provision. So out of the Rs. 600 crore, whatever is 31 DPD, it is about some Rs. 120 crore or so, Rs. 130 crore, we have taken provisions of 80% of that. So, we believe in dealing with issues, whenever they come immediately. But most importantly, this time we were able to call really early the early warning signals and we are at, as you rightly said, Rs. 600 crore at the end of the quarter, as we go ahead we are already lower further. There are still developments happening there but we believe we are fully



ready and done quite well in reacting to the Assam situation, even before the industry started talking about it.

As far as Orissa is concerned, the industry is once again talking about Orissa. 12 months back we were the lone horse, perhaps criticized for our Orissa issue. You remember we had taken a large provision in Orissa, calling the problem early. We believe that some parts of the industry are having a problem now. Whereas in this quarter itself, our Orissa collection efficiency is back to 99.9%. Plus, we have recovered in this quarter itself about Rs. 25 crore from the amount that we had written off one year back. The micro loans business, has a higher ROE because it is subject to event risk. But it is all about how you manage event risk, how you get early warning signals, how you react to those early. And then of course, when there is an issue, how you take provisions and stop giving shocks to P&L.

Kunal Shah:

So, does it mean that we have provided Rs. 90 crore to Rs. 100 crore on this Rs. 600 crore?

Dinanath Dubhashi:

Rs. 112 crore.

Kunal Shah:

In this quarter itself, in this Rs. 276 crore?

Dinanath Dubhashi:

That is right.

Kunal Shah:

Okay. And just last one question in terms of the opex, so the overall opex growth has also been quite high in this particular quarter. So what's been the reason for this?

Dinanath Dubhashi:

One is just technical and other is strategic. Technical is, the last quarter had a GST credit of Rs. 23 crore, and there is no large GST credit this quarter. But there is something that I will explain.

One, as I have always said, when disbursements are down, especially in areas like rural, retail housing where you have to keep your network in place with dealers, with builders, etc., yes, you can change them, can adjust them. But that's not as fast always as the volume going up and down.

Secondly, as I have explained last time, if for one dealer I put two persons, and the volume is down 40%, I can reduce it to one. But if I put one person I can't reduce it 0.4 or 0.5, right? This will happen normally, at the time when business is down. And as the disbursements starts picking up, our productivity in farm has actually gone up this quarter, from about 8 or 9 per month per person to around 11 per month per person. Whereas in two wheelers it has come down, micro loans as you can imagine, with Assam and all, the productivity is way down naturally. Disbursements have been down from Rs. 200 crore to Rs. 34 crore a quarter, right? So, it will happen temporarily till we either increase business or adjust manpower there, so that is reason number one.

Reason number two is, we have paid tremendous amount of attention to keep portfolio quality and especially early collections in check. Having said that, the most important and cheap method of doing early collections is call center and asking the customer to come to a collection center and pay. As situation becomes a little difficult, a higher percentage of accounts are not closed by the call-center and given to the



branch team or collection agency to collect the payment. And that reflects in the expense column. It also, we believe, recovers a part of it through fees, through dealer collections, it comes in the income column the delayed interest for example. So, you would also see the margins a little bit higher than what we have been guiding you, we have been guiding you between 6.7% to 7%, the margins are 7.29%. It has some, I may not be able to go into details, some elements of delayed payment collections, delayed interest, etc.

See margins and expenses, some part of it will go hand in hand. So, you cannot look at just one thing in itself. I can assure you that the management has it in full control. And our push will always be for efficiency. I wouldn't like to commit next quarter how much we will reduce, but you can be rest assured that we have done it before and we will try and make efficiency gains as we go ahead.

Having said that, till the situation in the market remains difficult, we had to invest a lot of manpower, double the expenses to check collections etc. Assam for example, 8 to 10 days internet was closed. So then you had to have a manual process. These things also take expenses. Last but not the least, we will continue to invest. Also, we are investing in a new product, building a state-of-art systems for the new product. So does that answer your question? Short of giving you guidance as to what the expenses will be in Q4, I have given you a lot of explanations.

Moderator:

Next question is from the line of Karthik Chellappa from Buena Vista Fund.

Karthik Chellappa:

Couple of questions from my side. The first one is, if I were to just look at our weighted average costs on the funding side, so for the first time after seven quarters it is actually down sequentially Q-o-Q. And at the same time, we have raised about Rs. 10,000-odd crore long-term money, which is like you put it earlier in your comment, that the highest in any quarter since FY17. I am just trying to reconcile the two, we have raised a significant amount of money long-term, but yet sequentially our weighted average cost is down, which is again a first in seven quarters. How should we reconcile this?

Dinanath Dubhashi:

Sure. I can be very modest and say that, okay, the industry cost itself have gone down, which is true. The AAA spreads on bonds has gone down quarter-on-quarter, no doubt, and full credit to that. But also I can be a little bit immodest and say that, we have almost cornered the priority sector raising market, which is at a substantially lower costs. I will not go into exactly how much, but reasonably sub-8 cost for this priority sector. So that is available at least till 31st March and we will take full advantage of that.

Karthik Chellappa:

So, can we say that from here on, on a weighted average cost curve basis things will only improve for you?

Dinanath Dubhashi:

Maybe more steady at this point of time is what I will say. Last time I had given a guidance of actually 10 basis points increase, and we reduced it. And frankly, it will depend on how much money we will be able to raise on this PSL further. Also, whether we increase our CP by maybe a percentage or so. I think I will conservatively take it at the same rate and try to do better than that.

Karthik Chellappa:

Okay. My second question is on the microfinance portfolio. Thank you very much for the detailed explanation on Assam. And you have been articulating your strategy pretty clearly, that you want to go into less penetrated geographies like Punjab or Haryana or so. But on the data points that you just had, I just



have two follow-up questions. Firstly, you said that as early as in the fourth quarter of last year, your rejection rates started to go up and that continued in the first quarter as well. Just as a principle for microfinance business, could you share what all signs did you see in your database for the rejection rate to actually go up?

Was it like multiple lending, the number of lenders are pretty high or was there an aggressive player crowding out everybody with larger ticket sizes, or was it related to income? Any color on that front would help. And secondly, on a rundown Rs. 600 crore portfolio, essentially our 31-day DPD is like about Rs. 120 crore to Rs. 130 crore, which is basically 20% of the portfolio is what we have kind of classified at risk and taken 80% provisions. I would think that looks like a slightly high number. So any color on why that number turned out to be so high? It would effectively mean that certain districts or certain meeting centers effectively the whole amount needed to be written off basically?

Dinanath Dubhashi:

No, it is not written-off. So let me take one by one. On the aggressive player, lending so much, etc., I am not going to comment on that. So very simply the early warning signals as a principle, cannot be based on our portfolio. Because if it is seen as our portfolio, it is not early. If it is 1 DPD in my portfolio, it is not an early warning signal. It's a late signal. It has to be based on overall market data. And as I said, the three things that we see; number of associations, overall indebtedness and my credit rejects.

These kind of metrics are seen. Based on that credit rejects increase in a particular area. And based on these three, business and risk both start taking notice. And that is where what is the automatic mechanism, then we start taking subjective notice also what keeps happening. And then based on that, we either put a particular meeting center on rundown, etc. So that is number one.

Number two, the point that you raised, this business is an amortising business. Let us say a regular collection efficiency is, 93% for a month, does that mean 7% is 31 day and up? It is not. You get?

Karthik Chellappa:

Yes.

Dinanath Dubhashi:

It is simple, these two things will have to be matched. That's why we take 31 days and up as standard asset provisions. And while these provisions are a part of my P&L, they are not a part of my provision coverage. They are standard asset provisions, they are coming in Stage-1 and Stage-2, the additional provisions that we have taken.

So as we maintain collection efficiency, the collection efficiency in Assam overall is around that number, early 90s. And 7% of that approximately will get every month into this, till it reaches 90 days. And that is what has happened, 120 days is 31 DPD now. Largely, we believe that the affected areas have reached there. Whatever is less than 30, we believe is in ball in play, we can collect. And of course, a large part of the portfolio still remains zero DPD. It does not mean that this Rs. 120 crore is a write-off. That is why I gave you Orissa example, that in Orissa also we took very conservative provisions of Rs. 150 crore in one quarter, after that we didn't have to take any more provisions for Orissa. And on top of it, we have recovered money.

What we are doing is we have acknowledged that this is an issue. How we are dealing with it is very active engagement with customers and all relevant stakeholders. We have increased meeting coverages by appointing additional manpower there, and clearly clarifying the issues by explaining our practices, removing any misinformation, etc. We can confirm that we enjoy, LTFH enjoys unfettered access to customer even today. That doesn't mean that all the customers are clean, but we are not facing any 'gram bandhi' or anything like that. We believe it is a certificate to our practices.



Moderator:

Next question is from the line of Aditya Jain from Citigroup.

Aditya Jain:

Really good to see the steady asset quality in the quarter. I was wondering if you could elaborate on a couple of things. One, the Supertech reduction in exposure to that account that you talked about in the last quarter, how is that progressing? And secondly, the defocused book rundown. If you could give us some color on what is the market demand? Is the sell-down happening below or above book value?

Dinanath Dubhashi:

Okay. So the first one, Supertech, I wouldn't go into absolute details right now because a lot of it is work-in-progress. I can only confirm that things are going well on plan. We have a couple of plans, maybe one is going a little late, two are going a little earlier than planned. Largely, it involves the following, it involves doing DM arrangements for some of our projects and sale of the additional property, hotels, malls, etc., that we have. A couple of them, the term sheets are already signed. One, the money has been received and a few more are under discussion. So as we had said, we should be able to report a decent amount of reduction by March. And then we will give update at that time that how do we see it going ahead. So that is as far as Supertech is concerned.

As far as the defocused is concerned, the numbers are there. I will also say how we are achieving it. So the numbers are quite good. We had indicated about Rs. 5,000 crore by end of the year, and you would say that we are already very close to that number, and the reduction has been impressive. It has been achieved with two ways, the DCM book, obviously, with the exception of Housing finance company, we are selling down pretty rapidly. If we make a particular loss on some, we also make profits on some others. So obviously, the hit to balance sheet and P&L is not at all there. I mean, this quarter it is not at all there, forget negligible, etc. So the DCM book is coming down very smartly based on that. Obviously, we wait for opportunities. It is no panic sale, we are ready to hold. But we look at opportunities and sell down pretty aggressively.

As far as the structured finance book is concerned, there are some normal repayments happening. There are some difficult account resolutions which happened. You have one example where one media group sold its equity in two phases and we got a majority of the money back there. These are not bad assets, it's okay if it continues, and it gives good yields. But we have promised the investors that we will reduce to Rs. 5,000 crore by March 31, and we will.

Aditya Jain:

Got it. And on the margin side, so you have already given us some details, but could you just clarify. So you mentioned there were a couple of recoveries and one-offs, which helped the margin in this quarter. How many basis points, how much impact would that have had?

Dinanath Dubhashi:

I wouldn't go into those details. I can only say that we guide conservatively between 6.8% to 7%- 7.1%. We are confident of maintaining that, and we are confident at maintaining our PPOP levels and credit cost levels to deliver the final ROA. There can be plays in some of these areas quarter-on-quarter. But on the annual basis, we would like to maintain it steady.

On margins, there is another fact. You also have to take the change in product mix. So as we do rural more, margins will go up. On the other hand, as Real Estate is reduced, margin will come down. And we give business-wise margins also, so you can do your calculations based on that.



Aditya Jain:

Got it. One thing if you could clarify. Sir, you mentioned early signs of stress in some sections in microfinance. Which particular states, if you could go into the details?

Dinanath Dubhashi:

No, there is no stress. There is no stress as it is understood as reduction in collection efficiency, no. When I speak stress, maybe sometimes I am misunderstood because I normally start indicating one year in advance and hope that nothing bad will happen. Assam also, if the situation would not have come to a political unrest, the industry would have managed. So the final problem is of political unrest. But early warning signals and actions happen on many other things and not political unrest, because by the time the political unrest happens, it's too late.

So as I said, certain areas of certain states in east, maybe in south, certain districts are seeing crowding, are seeing increase beyond comfortable levels in total indebtedness and number of associations. And those areas, we have already started reducing. So this is the explanation I was giving for not promising any growth in microfinance. Because it's microfinance and there is so much demand, there is so much under penetration and so much scope for financial inclusion, why growth is not possible - it is because of this. If microfinance is done as normal financing business, which it is, you give money and then you have to collect it back, I don't see any difference between that and any other retail loan products. And hence, all the principles of a normal retail loan product has to be applied to microfinance. And that's what I was talking about. I was not talking about any obvious stress.

Moderator:

We take the next question from the line of Renish Bhuva from ICICI Securities.

Renish Bhuva:

Sir, a couple of questions. One is on the write-off. So if you can just tell us the total write-off in this quarter versus last quarter?

Dinanath Dubhashi:

There is nothing significant difference from last quarter.

Renish Bhuva:

In the press release, there is one line item which is most probably related to selling down of assets, write off of financial instruments at amortised cost.

Dinanath Dubhashi:

The line above, has to be seen together. My CFO and IR will give you a detailed clarification.

Renish Bhuva:

Okay, sir. And sir, just more strategic question on the rural finance side. So sir, from last three, four quarters actually, there has been a consistent decline on the net interest margin. Of course, I think one of the reason might be we are de-growing sort of our microfinance book which is a high yielding book. So, going forward, let's say, next couple of years, what could be a steady state or, I would say, sort of margin you expect on the rural side, sir, depending upon your loan mix strategy, etc., etc.?



Dinanath Dubhashi:

See as I said, I don't decide my product-wise growth at the beginning of the year. There are internal budgets, but those are largely taken as very directional. We decide quarter-wise based on early warning signals with small PIN code that we will grow which product. I can confirm two things. That product wise, product by product we don't see margins either reducing drastically or increasing drastically. If there is a reduction in cost of funds, we will be competitive and pass it on. If there is an increase in cost of funds, which looks very, very unlikely, we have shown the capability of passing it on. So as you rightly said, the margin will really depend upon the product mix going ahead.

So actually you see Q3 FY20, the margin is 11.9% in Rural overall vis-a-vis Q3 FY19 11.64% and Q2 was 11.47%. So Rural margins have actually increased. And this is in line with just reduced cost of funds, frankly. This increase, or decrease will be something like this, 10, 20 bps. Rural, we are near leaders in this business, and hence we can't be totally out of the market. In fact, we are a very important part of the market. There is not much to read in rural margins. The day microfinance will be more compared to everything, margins will go up. If tractor will be more, then margins will slightly come down. And I can only say that over the next few quarters, at least I have a visibility on tractors being very good. So margins will be a little down, but there are so many other parameters in the P&L which also improve with tractors going up, like NPAs, expenses, etc.

Renish Bhuvu:

Yes, sir. So just last question on the microfinance side at the industry level. So sir, what's your team is suggesting? I mean, which are the states which are showing sort of, let's say, high rejection rate at the industry level, not specific to L&T Finance?

Dinanath Dubhashi:

So, some states in East and a couple of states in south. I wouldn't like to be more specific than that.

Renish Bhuvu:

Okay, sir. So would you like to comment on the rejection rate increase? Or I mean, what sort of increase, I mean, it's a marginal increase or you guys see there is a lot of over-heating there?

Dinanath Dubhashi:

Our overall rejection rate is 48%.

Renish Bhuvu:

Pan-India level?

Dinanath Dubhashi:

Pan-India level. And my renewals, i.e. my own customer, and this is a very important data, my own customers' renewal acceptance for the second cycle is in the early 30s. So my own customers, we end up rejecting around 68% or 69%. Because during the period that they are with me, they have gone and borrowed somewhere else.

Renish Bhuvu:

Right. So sir, what could be this data for the states where you are seeing like little stress for you also?

Dinanath Dubhashi:



Naturally, they will be a little above this weighted average.

Moderator:

Next question is from the line of Viral Shah from Credit Suisse.

Viral Shah:

I had one question on your AMC business given where the valuation for many of the standalone businesses are, is there any medium to long term strategy there?

Dinanath Dubhashi:

Even if we had we wouldn't be telling that on a call. I have to apologise but obviously I can't answer such question

Moderator:

Next question is from the line of Nischint Chawathe from Kotak Securities.

Nischint Chawathe:

Just one question pending from my side, and that is essentially on the defocused book. Now, I was just trying to understand any guidance out there, first thing. And the second is that there is a sharp reduction in the net worth of the defocused book this quarter, which is in addition to the loss that you would have reported in this segment. So just trying to understand what are we looking at in this segment from here on?

Dinanath Dubhashi:

Okay. See the net worth part I can ask my IR team to help you with that. But guidance, we have always maintained Rs. 5,000 crore by March, we hope to beat that guidance a little bit, that's it.

Nischint Chawathe:

Sure. I will take the data offline. Okay and lastly any guidance for next year or any estimated loss or anything of that sorts?

Dinanath Dubhashi:

The estimated loss? Nothing unusual. We will try and not give shocks in that. Yes, as you have said, we have taken provisions this quarter. We will make, as I said, once the wealth transaction is closed, and it should be closed very soon, it is waiting DEA approvals, the profit from that also we will sort of allocate as provisions for any future sales, etc., for this business, which will strengthen our hands to reduce this portfolio much faster.

Moderator:

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

Dinanath Dubhashi:

Thank you. I think very, very good questions. It allowed me to clarify a lot of things. Thank you all of you for your patient listening. I will once again only end with giving a promise. So one thing, I think the big difficulty of the sector for the last year was liquidity. I think a good company, not only LTFH, admittedly all highly



rated companies with strong parentage, we believe are out of it. We can raise funds, there are two indicators of that. One is, we have started, again, negotiating and troubling our lenders for the best rates. Till now we were happy raising the money, we have started troubling them.

Second indicator is the attention paid by MD on this particular area, which was high it has now come back to normal. And of course, the CFO keeps a very close watch on it and the treasury. But my own attention is back to strategy and charting a route for the company over the next two to three years rather than liquidity for that quarter. So, that thing is behind us. As far as growth is concerned, I will once again say, yes, a lot can be read into -20% disbursement growth or a 15% growth in book on focused businesses. I can only say that we believe that as we are in financing business, whatever we grow is for three to five years, it can come and hit you. And hence, runaway growth in times like this will always be toxic. We will continue to concentrate on asset quality, profitability and liquidity first. And at this point of time, growth will be a result of effectively managing all other three.

At the same time, our complete confidence to you that we will keep investing smartly and efficiently based on our data analytics on things which are required, the building blocks for growth. And I am very confident that when growth returns to each of the segments, we will be able to grow better than market. In any case, in some of the areas like real estate, there is big scope for growth, but we are moderating, obviously, as we have promised for completing our projects and only concentrating on top quality builders.

So I would read less in this quarter's growth and more into our capability of our growth strengths, business strength and ability and what's shown track record of maintaining steady results. Thank you for all your confidence and support and hoping for the same as we go ahead. We always need your good wishes. Thank you. Keep it coming.