"MAS Financial Services Limited 1QFY19 Earnings Conference Call"

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MODERATOR: **MR. RAHIL SHAH – AMBIT CAPITAL**

Moderator: Ladies and gentlemen good day and welcome to the MAS Financial Services Limited Q1FY19 Earnings Conference Call hosted by Ambit Capital. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Rahil Shah from Ambit Capital. Thank you and over to you sir.

Rahil Shah: Good afternoon all. Welcome to MAS Financial Services 1QFY19 earnings call hosted by Ambit Capital. Today, we have with us Mr. Kamlesh Gandhi – Chairman and Managing Director, Mr. Mukesh Gandhi – Whole time Director and CFO and the senior management team with us on this call. I will now hand the call to the management for the opening remarks and thereafter we will open the floor for Q&A. Over to you sir.

Kamlesh Gandhi: Thank you, Rahil. Good afternoon everybody and I'm happy to connect to all of you once again. The purpose of this con-call is to take you through the performance for the Q1FY18-19, as already published. Before that I would like to draw your attention that I will be taking you through the IGAAP numbers also in order to make you understand the comparative performance of the company in the corresponding period and then they will take on the Ind-AS numbers too.

So, starting with the IGAAP numbers for the performance for the quarter, the growth in AUM for Q1 this year is around 30.07% that is Rs 4,257.48 crores and the growth in profitability is around 45.70% that is Rs 33.57 crores. Asset under management for the corresponding quarter was Rs 3,273 crores and the profit for the corresponding quarter was Rs 23.04 crores as per IGAAP numbers. If you see the quality of the portfolio that we have maintained, the GNPA is around 1.19% resulting in a net NPA of 0.95% on AUM and for the corresponding quarter it was 1.17% and 0.99%. So, once again consistent with our track record of so many years that we have always concentrated on quality growth and we personally believe that is what we are mandated to do.

If I take you through the various product lines, our main product comprises of micro-enterprise loans, small and medium enterprise loans, two-wheeler and commercial vehicle loans which is distributed directly through more than 3500 centers and through our association with more than 100 NBFCs. Growth in each of the sectors - micro-enterprise loans grew at 36.34% from Rs 1,995 crores to close to Rs 2,720 crores. In SME loans the growth was by 20.39% from Rs 836 crores to Rs 1,006 crores and in two-wheelers it is Rs 386 crores from Rs 319 crore last year and in commercial vehicle we are at Rs 144.18 crores from Rs 122 crores last year. So, this gives us an aggregate growth of around 30.07% as compared to the last quarter.

In terms of distribution around 59.64% of our assets are created through our distribution model through various NBFCs. Now before coming to the housing finance, if I just convert this into IndAS application, as we all know that we have started preparing our account as per the Ind-AS guidelines from this quarter; if I take you through the Ind-AS implications, the asset under management growth is around 30.33% with a slight difference as compared to IGAAP because of the various accounting treatment that has to be undertaken because of the IndAS implications; that takes the profit before tax to around Rs 46 crores, which is a 60.71% rise and profit after tax to Rs 30.46 crores as compared to Rs 16.77 crores, which is 81.64% rise. Now GNPA and NNPA is replaced by the stage-wise classification of the asset; the point which has to be highlighted is - the Stage-3 asset is 1.33% of our balance sheet assets and net Stage-3 asset is 1.13% of our balance sheet assets and if you convert it on AUM basis the GNPA that is Stage-3 is 0.97 and 0.98 respectively for 30th June '18 and '17 translating into a Stage-3 of 0.85 and 0.88 respectively on June 30th, 2018. So, in short even after implications of IndAS the quality of the portfolio is in the same trajectory and that is the main focus of the company over the period of time to have a calibrated and a quality growth.

Once again the profitability and the growth parameters can be better understood and better compared because on the IGAAP basis for this year because of the transition impact and transition effect that will be there for the previous year and hence in our presentation also we have endeavored to give you the complete comparative statistics as per IGAAP so as to facilitate you to understand operations of the company in the right perspective and at the same time the implication as per IndAS is also shared with you.

If I talk about our housing finance business, the silver lining in this business is the quality of the assets that we have maintained and according to us the right approach for all the housing finance companies in the affordable space is to build up a base of customers and an operational base in such a manner that we can maintain the quality of the assets because getting the top line and getting the disbursement numbers is very easy looking at the huge market size. Coming to the numbers on it, the growth in AUM for housing finance is at 17.39% that is from Rs. 178 crores last year to Rs. 209 crores, rise in profit by 19%, rise in profit after tax by 25% and once again we have endeavored to still improve on our GNPA and NNPA that is from 0.44% to 0.33% and NNPA from 0.36% to 0.24%; how it translates into IndAS, the growth in asset is 17.94%, the gross profit is up 10.09% resulting into a profit after tax rise of 14.28% and the Stage-3 asset are 0.36% before provisioning and if you account for provisioning it is 0.26% as compared to 0.39% and 0.28% on AUM. So, this is the operational result for the quarter. As I shared with you this has been the result for many of our last quarters, where we registered a growth anywhere between 25% to 35% in AUM and as well as 25% to 35% in profitability and maintaining the quality of the asset.

Going forward, I would like to share with you, as I shared in my communication in the starting of the year, that we will endeavor to have an AUM anywhere close to Rs. 5000 crores to Rs. 5250 crores including our housing finance subsidiary which might result into Rs. 190 crores to Rs. 200 crores of PBT; these are the projections as per the GAAP numbers. We all have to wait and see how it unfolds as per IndAS applications but on a comparative basis this is what we anticipate to do and we are working on the same.

Just to take you through how we do our business, once again, the focus is on our main product that is MAC and MEL, that forms a formidable part of our AUM; around 85% to 86% is the same and how we operate has been shared with you number of times at various forums and at various meetings. But to summarize once again, the idea is to be their advisors first, understand their liability management and then be a part of that provider and this approach has helped us to generate quality portfolio. At the same time we see lot of scalability with a challenge in the same vein that how it systemize our learning from time to time and we are working very hard on that and evident from our performance, we have been incrementally increasing our understanding of this product and in a position to register a very quality growth.

If I talk to you about our distribution model, if you see our investor presentation, there were suggestions from many investors to elaborate on our NBFC distribution model so there are around 4 slides dedicated in our presentation on how we do our NBFC distribution model and which is very evident on our understanding that why we prefer NBFCs over a conventional channel of BSAs or franchisees, what are the impacts, how we do operations and how going forward we see the growth prospects and what has been our track record over these years has been demonstrated in that presentation. But to summarize this is close to a 10 year business model and we could achieve our objective, we still see lot of prospects of a very efficient last mile delivery of credit because we are working in the informal class. Value chain approach in informal class plays a very important role and following the informal class is not a business of balance sheet size. It is about understanding the demography and that is where this partnership with NBFCs has resulted into a very efficient last mile delivery of credit.

So, this is about the performance, this is about our distribution. The product - we will like to continue to focus on the same product because we see lot of scope and will just the surface to see the list and with our own distribution strength in 6 states, we were from close to 78 branches, 3500 centers, we see lot of prospects to fuel our growth at the rate at which we want to grow, maintaining the quality. So, this is from our side on the asset creation. Transition to IndAS - once Mukesh bhai talks to you about the strategy on liability raising, we will take you through transition on IndAS and how exactly it has affected the company in terms of net worth, the profitability and how we have projected, it will be shared with you. I request Mukesh bhai to take you through the liability strategy of the company.

Mukesh Gandhi: Thank you Kamlesh. Good afternoon everybody. So far as the borrowing side is concerned, there is not much change in the borrowing composition. We have been assigning our portfolio to the tune of 35% to 40%. This quarter, the total portfolio assigned is 37%, amounting to Rs. 1597 crores. The remaining is by way of cash credit facility and by way of term loans and as we have discussed earlier, in cash credit limit - we block the cash credit limit and avail the WCDL so that reduces our cost of borrowing. If you look at the cost of borrowing then in this quarter the cost of borrowing has been 8.74%, in March it was 8.67%. You all are aware that the rates are hardening, but in spite of that we could manage within 7 bps of our borrowing cost. In June, 2018 it was 8.98% and from last June to this June there is a change from 8.98% to 8.74%. If you look at the marginal cost of borrowing then it is around 8.6%. The reason being every quarter the borrowing product mix will be different. In the first quarter, our major borrowing was through the CC and WCDL and our marginal cost of borrowing is 8.6%. This is how we have been maintaining our liability management in a very tight way so that our cost of borrowing remains under the control and in competitive environment it is very much necessary to have this aspect at place otherwise the profitability will be impacted in a negative way. With that I handover to Kamlesh bhai to take it for the IndAS.

Kamlesh Gandhi: Just to briefly take you through the impact of IndAS on profitability, if you can see in the presentation, on Slide #34 it has been given in detail. But if I summarize the same, the impact on profitability as far as IndAS is concerned in Q1FY19 is from Rs. 33.5 crores of PAT looks at Rs. 30.4 crores as per IndAS and for the corresponding period Rs. 23.04 crores of PAT looks at Rs. 16.7 crores as per IndAS. The impact on net worth as on 31st March, 2018, Rs. 713 crores of net worth is Rs. 752 crores and the impact on April 1st 2017, Rs. 326 crores of net worth looks at Rs. 161 crores as per IndAS. If you see Slide #35, there is a note for your reference that this was mainly because of de-recognizing CCPS and CCD from equity and recognizing as liability as per the IndAS requirement and the same has been once again reversed in September 2017. So, that was a very temporary effect that came on the balance sheet but it has been reversed because of the conversion. As you all know that we went for an IPO and all the convertibles were converted so it has no impact on the net worth if we talk as on 31st March, 2018. So, once again the Rs. 713 crores looks like Rs. 752 crores. But for the year, as I shared with all of you, we will be concentrating on the performance parameters more on IGAAP because that according to me will be a better idea to compare the performance. The performance as per IndAS can be affected because of the accounting entries and the accounting impact that we might have to do in a retrospective manner.

Now coming to one of the most pertinent aspect of IndAS is the credit quality. We are very happy to share with you that it was a very extensive exercise on the track record of the company to arrive at PD and LGD. At the end of the day the result was in sync with what we have done over these years. For your reference on Slide #36 we have given you the Stage-1, Stage-2 and Stage-3 bifurcation and the provisioning thereof. We have a total of Rs. 4316 crores of portfolio categorized into various categories, including the assigned portfolio on which we are not subject to any provisioning because it is without recourse. If we talk about on balance sheet portfolio of Rs. 2759 crores, around Rs. 2624 crores is in Stage-1, Stage-2 is Rs. 110 crores, Stage-3 is around Rs. 36.64 crores and against that the respective provisioning is Rs. 8 crores, Rs. 11 crores and Rs. 5.3 crores which results into Rs. 24.85 crores of provisioning. For better understanding, if we translate into stage wise and relating the way we know it, the Stage-1 and Stage-2 are regarded as standard asset, the provisioning is 0.72% now which usually we used to keep at 0.4% formerly and Stage-3 that is more than 90 DPD assets is 14.47% which we used to keep anywhere between 10% to 20% historically. So, when we talk about 14.47% provisioning on Stage-3, it's based on the track record of the company as to the loss that company will have to incur given the probability of default based on the past track record. That is what I was trying to convey that it is more on the lines of what we have been doing since long and is valid with the fact that with that approach we were in a position to maintain the quality of the asset. Now if you want to convert the Stage-3 on the percentage on AUM and on-book assets, they are more or less the same way like GNPA and NNPA. So, if we talk on AUM Stage-3, after provisioning it is 0.85% of the total assets. So, this is how the ECL impact on the credit quality of the portfolio is and we all know that we are in a transition phase. Every quarter we will understand, we will learn, we will unlearn and see how we can maintain the quality of the portfolio and have the right provisioning. We are aware and conscious of the fact that we are a leveraged organization and a right provisioning plays a very important role. So, this is about the impact of IndAS on MSFL. As far as MRHSL is concerned, looking at its size and the type of operations, there is a very marginal impact. But if I take you through that, the profit after tax on 19 Basel which was Rs. 8.97 million is Rs. 9.08 million and for the corresponding quarter which was Rs. 7.14 million is Rs. 7.88 million and impact on the net worth according to IndAS in 18 which was Rs. 320 million or Rs. 32 crores is now Rs. 30.6 crores. Once again there was an element of optionally convertible preference shares and we intend to convert that into equity very soon. So, we think that this also will be offset. In April 2017, net worth as per GAAP was Rs. 29.91 crores which according to IndAS is Rs. 29.45 crores, so hardly any difference there.

On the credit quality as far as our housing portfolio is concerned, if we see Stage-1, we have total of Rs. 210 crores out of which Rs. 2.6 crores is assigned and we need not provide anything on it. This is on Slide #40 and I'm talking about June '18 numbers. Stage-1 is Rs. 197 crores, Stage-2 is Rs. 9 crores and Stage-3 is Rs. 70 lakhs. The total provisioning is around Rs. 1 crore and if you translate it into percentage, Stage-1 and Stage-2 standard asset provisioning is 0.4%, corresponding period was 0.41% and Stage-3, 90 DPD assets provisioning has been 27.43% as compared to 27.91% last year; that has also translated on an AUM basis. Our endeavor always has been to bring forth our operational figures to the investors and the lenders so we always give the number on AUM to understand how we exactly manage the portfolio, whether it is with recourse or without recourse. It is 0.26% of AUM after provisioning. So, this is the IndAS impact and as I told you this is the first quarter of impact. We have been engaging with our auditors very closely. We have been engaging with other consultants also very closely. We have already conveyed to our auditors that it is a matter of capturing the right commercial intent along with the compliance of laws and not only compliance of laws which does not reflect the right commercial intent. I think it is incumbent on the auditors to understand this and see how they come with the solutions. We had lot of discussions with them and they were very patient in discussing all the things. Nevertheless, it was followed strictly as per the IndAS criteria. But once again as we go ahead with that discussion, we will continue to discuss the same with the auditors because I very firmly believe that IndAS or GAAP, at the end of the day the objective is to give the right picture to the investors and all the stakeholders. So, this is from us; this is the first quarter of operation and as always team MAS is dedicated on its mission of excellence to endeavors and we value the support of all the investors and the lenders.

Thank you so much for your patient hearing and now the session of question and answers may begin. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Kislay Upadhyay from Abbacus. Please go ahead.

Kislay Upadhyay: Could you give outlook on the loan book mix?

Kamlesh Gandhi: That has been already shared.

Kislay Upadhyay: As in by outlook I mean guidance.

Kamlesh Gandhi: Guidance as I told you that we will continue to consolidate on our core products that is MSE and SME and it will be anywhere between 75% to 85% of our total assets in the foreseeable future because we see a lot of scope. We have developed a niche expertise in the same and this is how we see it going forward.

Kislay Upadhyay: Could you help me with the yield on the loan books?

Mukesh Gandhi: If we tell the yields product-wise so MEL our rate of deployment is around 15.42%, in SME our rate of deployment is 15.46%, in two-wheeler it is around 18.18% and in commercial vehicle it is 17.51% for this quarter. So, its average yield.

Kislay Upadhyay: Also could you help with the spread on the off balance sheet part or the cost of borrowings of the off-balance sheet part of the AUM?

Mukesh Gandhi: Cost of the funds for off balance sheet item is around 8.5% to 8.6%. We always deal on one year MCLR.

Kislay Upadhyay: And the yields even on that part would be the same as the rest of the book.

Mukesh Gandhi: Yes.

Moderator: Next question is from Ritesh Mehta from Motilal Oswal. Please go ahead.

Alpesh: This is Alpesh here. One question is related to your assignment transactions; when I look at the Indian GAAP versus the IndAS numbers, the gain on assignment seems to be on a lower side so anything specific on that front? Because normally in case of the assignment transaction now the gains have to be up fronted right?

Kamlesh Gandhi: They are up fronted and on the lower side means in what terms are you telling lower side?

Darshana Pandya: The major impact is in the numbers of March '17; that is opening 17-18.

Alpesh: But there would have been new assignment transactions done in FY18 as well.

Darshana Pandya: Yes, but then we're getting the reversal of earlier income also. On quarter-on-quarter basis the income which we have booked upfront, we are getting the reversal and then against that we are booking new income so if we do assignment; last quarter if I tell you, the number of transactions were 3 to 4 and the amount was Rs. 364 crores compared to other quarters.

Ankit: This means that because we have done transactions before also and the flow has been carried out but the positive impact will come from the September quarter.

Alpesh: That's not what I meant. My question is if you had around Rs. 38 crores of adjustments at the opening net worth and then obviously you would have also done some assignment transactions during the year, so there would have been some redemption on the assignment portfolio simultaneously addition in the assignment portfolio. Our assignment portfolio in the absolute term is not coming down, it continues to go up. So, the gain should also be a part of the net worth; wouldn't that be the case? Any which ways I will take it off-line that's not a problem.

Kamlesh Gandhi: So for the opening, it's Rs. 38 crores income which we have booked and as on March '18 it increased from Rs. 38 crores to Rs. 57 crores. But when we talk about June quarter, from Rs. 57 crores it reduced to Rs. 53 crores so that way the balance is carrying off. That's why you are not seeing the impact in first quarter but that was there till March 18. The overall impact has come till March 18 numbers.

Alpesh: I was looking at Slide #35, the adjustments which are given under Indian GAAP versus the IndAS.

Kamlesh Gandhi: So, if you combine two years number…

Alpesh: These are the balance sheet numbers right?

Kamlesh Gandhi: No, there is an impact of carry forward of last year's transactions. That's the last line if you see; that is carrying the impact of the last year.

Alpesh: Last year impact of transaction is around Rs. 121 crores.

Kamlesh Gandhi: So, that carries all the impact for the last year. This is for the year impact which has come to the financial apart from the carry forward impact.

Alpesh: And what would be the gain on assignment transaction booked in this quarter and just as a suggestion if we can put it as a separate line item because at times this can become a lumpy income or it can come down significantly depending upon the market scenario so if we can have it as a separate line item in the presentation that would be very useful.

Darshana Pandya: Yes sure.

Alpesh: And what is the number in this quarter?

Kamlesh Gandhi: If I talk about quarter wise, in this quarter we have reduction in income. Upfront income total overall would be Rs. 53 crores, which we have booked till June.

Alpesh: For the quarter how much would it be? Out of Rs. 128 crores, Rs. 53 crores seems to be very high number.

Kamlesh Gandhi: This quarter we have done Rs. 360 crores of assignments.

Mukesh Gandhi: In that the upfront income is Rs. 53 crores. We have an outstanding of Rs. 1500 crores of assignment transactions and in that, the income which was booked was Rs. 58 crores, which has been reserved.

Alpesh: So, earlier we have booked in March '17, Rs. 38 crores and till June we have to book Rs. 53 crores so the difference is coming in the quarter which is looking….

Mukesh Gandhi: But in September because it will be only this effect, therefore it will be highly positive.

Kamlesh Gandhi: It all depends upon what amount of assignment we do.

Mukesh Gandhi: In June quarter we do less assignment. But in September if there and we would have done around Rs. 500 crores to Rs. 600 crores of assignment, then the impact would be very high. There would have been very positive impact because our base is Rs. 1500 crores. So, our base is Rs. 1500 crores and that income has to be reversed for the quarter.

Alpesh: That income has to be reversed for the quarter?

Mukesh Gandhi: Because that has to be booked upfront.

Alpesh: So, that you would have booked in the previous quarter, right?

Mukesh Gandhi: Yes.

Alpesh: There is no point of reversal of the income isn't it? When you did the transition all these adjustments would have been taken place in the opening net worth of 2018 or 17, so there is no point of reversal of those incomes, right?

Darshana Pandya: Can we share these numbers with you.

Alpesh: We will take it off-line. I think it's getting too confusing here.

Kamlesh Gandhi: There is lot of reconciliation in this.

Alpesh: I think so assignment is bit confusing over here. Nothing else.

Moderator: Next we have a follow up question from the line of Kislay Upadhyay from Abbacus. Please go ahead.

Kislay Upadhyay: Coming back to my previous question on the guidance on MEL and SME loans; you said it to be around 70% to 75%.

Kamlesh Gandhi: Yes.

Kislay Upadhyay: Which other books we would be looking to grow significantly?

Kamlesh Gandhi: It will be in the same lines. If you see the current configuration, around 85% of the portfolio is from SME and MEL; two-wheelers and commercial vehicle contributes around 12% to 15%. So couple of percentage configuration this should be the line of growth going forward. This is what we anticipate.

Kislay Upadhyay: I was asking because currently it's about 85% and bringing it down to 70% to 75%, the other books will gain about 10% to 15%.

Kamlesh Gandhi: 70% to 75% is over a period of time. This year we don't see much change in the configuration.

Kislay Upadhyay: Also on the cost can you give some guidance on the cost of the fund.

Mukesh Gandhi: Basically these rates have been hardened so the overall impact will be there in the balance sheet by the end of the year. But still we are endeavoring it to keep the cost under control. We have an advantage that we keep on assigning the portfolio which qualifies for the priority sector lending and there we get the final rates. And secondly our CC facilities also which we are using with WCDL, Currently our marginal cost of borrowing is around 8.6%. It may increase by 10 or 15 basis points over a period of time as and when the environment or the RBI policies unfold.

Kislay Upadhyay: Would this require a change in borrowing mix or an increase in yield?

Mukesh Gandhi: For current year it doesn't look like that because we are geared up for the entire year's assignment target so in this particular year 37% of the portfolio will be off the balance sheet and the remaining will be on the balance sheet with the configurations of CC facility and term loan facility.

Moderator: Next question is from the line of Rasheel Shah from Agro Capital. Please go ahead.

Rasheel Shah: My question was regarding your channel partners. How much of your portfolio would be through your channel partners and how much would it be through direct lending?

Kamlesh Gandhi: In Q1, as reported, we have around close to 59% of the business coming through channel and the rest through our direct distribution model.

Rasheel Shah: Could you highlight some of the risks associated with having 59% of your portfolio coming through the channel partners?

Kamlesh Gandhi: Every distribution would have its own advantages and disadvantages. So, if I talk about the risks, if we don't manage to identify the partners correctly then it will be one of the biggest risks. But as I told you the mitigant is our experience of 10 years working with them and if you see our slide presentation, we have very clearly mentioned how we select the partners whom we work with. So if you go by our track record, all the risks that is associated with this business, we have been in a position to very safely manage and navigate with those risks. So, the biggest risk if you ask me is to how you select your channel partners with whom you work and how you keep on engaging with them and how you go on evaluating them continuously from time to time.

Rasheel Shah: And what would be your margin with these channel partners?

Kamlesh Gandhi: When we talk about revenue sharing model, at the end of the day the returns what we get through our direct distribution and the returns what we get through the channel is almost same. So, our average rate of lending for the channel partner is close to 13.53% as on June 18 and with an average cost of fund—I am not talking about average cost of borrowing—in which capital is also factored in, at around 7.27%. The margin is at around close to 6.26% mean.

Moderator: The next question is from Rohan Mandora from Equirus Securities. Please go ahead.

Rohan Mandora: Just a few data-keeping questions; what were fresh disbursements during the quarter?

Kamlesh Gandhi: The fresh disbursement during the quarter was close to Rs. 1000 crores. Rs. 995.67 crores.

Rohan Mandora: How does that split between channel partners and the non-channel partners?

Kamlesh Gandhi: That I don't have the ready-made numbers here. It will be shared with you because this is the overall disbursement of 995.67 crores.

Rohan Mandora: How many new NBFC relationship we would have added during the quarter?

Kamlesh Gandhi: That is a very continuous process but around 3 to 4 new relationships are added this quarter and we work with close to 100 of them in the country.

Moderator: Next we have a follow-up question from Rasheel Shah from Agro Capital. Please go ahead.

Rasheel Shah: I just wanted to know about your customer retention. How much of your customers do get refinanced for another loan and what is the possibility of you cross-selling within those customers?

Kamlesh Gandhi: Our strategy as far as customer retention and giving another loan to the customer is concerned is once again based on the cash-flow. They definitely get the advantage if they have track record with us but every time a new loan is applied is as good as a new appraisal for us. So, taking this view into account where they don't automatically qualify for a new loan I think our repeat customer base must be around 30% to 40%.

Rasheel Shah: And cross-selling?

Kamlesh Gandhi: Cross-selling also is based on the same strategy. We have a call center whereby we do data mining and approach them from time to time and that gives us an opportunity to cross sell other products also. But as I told you the limiting factor in our class of customer is the level of indebtedness that once they have already taken a loan, their capability to take another loan as far as that loan is existing is very limited. So, we have to wait for one loan to complete and then we can cross sell other products.

Rasheel Shah: What would be your rejection rate for loans?

Kamlesh Gandhi: Rejection rate depends upon the product, centers and there are so many other factors affecting it. But if I give you a rough idea on our flagship products that is in SME and MSE, the rejection rate is anywhere between 25% to 35%.

Moderator: Next question is from Savi Jain from 2Point2 Capital. Please go ahead.

Amit: This is Amit here. Just wanted to understand how the competitive intensity is on the channel lending side especially with some of the SFBs also now wanting to finance other NBFCs and many of them are having lower cost of funds than you. So how do you expect competition to pan out over the next couple of years as these SFBs start becoming larger and larger and have more low cost deposits with them?

Kamlesh Gandhi: Just to answer the question, number one our approach to working with the channel partners is absolutely different as compared to what other lenders look at. For us it's not merely a NBFC lending or a corporate lending. It's more of an extension of our own business what we do directly. So with this approach there are number of operational differentiation that comes into play. If I just give you an example, NBFC with a Rs. 2 crores of disbursement per month cannot afford to have a Rs. 2 crores or Rs. 5 crores of disbursement in loan; that is where we understand the business model and disburse in tranches; just an example of the approach to what we have towards our partners and how over last 10 years we have scaled up at the rate of 40% CAGR. Coming to the competitive intensity, let me tell you all NBFCs have to continuously raise liability because asset and liability runs down continuously. Look at the balance sheet of any of the NBFCs', you will not find less than 25-30 lenders at a particular size. So structurally there is always a room for multiple lenders; what value you add at a different point of time will give you the premium on interest rate that you are supposed to charge. Coming on the SFB thing, the rate at what SFBs cost of borrowing; when I talk about around 7% cost of funds for me, there is not much difference between our borrowing cost and SFBs borrowing cost as of present and in foreseeable future, whatever they would improve on their cost of fund will be nullified to an extent by their operational cost. So if you take this dynamic into account, we have all the potentiality to be as competitive as any of the lender and over the 10 years, this space has been provided with a lot of capital and a lot of debt because when lot of capital is provided to the sector automatically they are eligible for raising more debt and 40% CAGR over last five years what we have demonstrated is in this scenario. So, that justifies that we have a very strong place in the liability management.

Amit: You mentioned there is a lot of funding that has gone to the space especially the small ticket lenders, the microfinance, affordable housing; are you seeing unhealthy practices developing in the industry, is there a risk of the underwriting standards deteriorating over time because of how more capital is chasing that space both from the equity and debt standpoint?

Kamlesh Gandhi: It is a very continuous feature of a lending business. If I tell you my experience of 20 years there are various cycles whereby people learn, unlearn and there are people who learn through their own assets through their experience, there are people who learn from other's experience. So, there is nothing new to this industry of being aggressive and then going into the shell. It's a continuous cycle that goes on in lending activities. So, there is nothing new because in last 20 years we have seen number of such cycles whereby they have been regarded as a very blue-chip factor then there will be many people who will be interested to put in more capital and then selectively they understand that they should be selective in giving capital and hence the debt providers will also follow the suit. So, this is a continuous practice, the deterioration of quality, quality of underwriting and then learning and then once again putting things in order - it's a very continuous practice here.

Savi Jain: **Savi here.** Your RoE has come up because of the equity raise. So what is the long-term sustainable target for the RoE?

Kamlesh Gandhi: 17% to 18%.

Savi Jain: And why is that because you have done significantly higher than that earlier so is it that you don't want to leverage as much as you used to earlier?

Kamlesh Gandhi: If you take a very simple calculation that if we have around 2.25% to 2.75% of RoA and including our assignment and on-book if we have leveraged around 6 to 7 times that will give you an ROE of around 17% to 18%. This is how we look at it because it is based on ROAs that we generate from time to time. So, with this thing in mind we see that around 17% to 18% will be the right ROAs what we should be targeting at.

Savi Jain: So, then in that case you will have to dilute because your growth levels are much higher, so you will have to do an equity raise.

Kamlesh Gandhi: If you see our history for last 20 years we have raised primary capital only two times and we have very strong internal accruals model. If you grow at around 25% to 30% then with an assignment of close to around 25% or so, we would be consuming our Tier I capital in such a manner that we might have to raise it every five years. We went public in 2017. I cannot predict future but as we visualize right now, we don't see us raising capital because if you see our capital adequacy ratio, it's more than sufficient currently.

Savi Jain: In terms of this channel partner business, do you have a concentration to each partner limit for that - how much is the maximum of the total advances that you can lend to one partner?

Kamlesh Gandhi: That depends upon the size and the quality of the partner but if I just give you a statistic - the top 10 borrowers constitute around 20% of our AUM.

Savi Jain: And in terms of the mix of these channel partners, is microfinance predominantly last part of these channel partners?

Kamlesh Gandhi: It must be around 50-50, around 50% our MSI NBFC and 50% are other NBFCs.

Savi Jain: Which is housing finance and even SME finance those kind of NBFCs.

Kamlesh Gandhi: SME finance, two-wheelers finance, commercial vehicles finance and all.

Moderator: Next question is from Tushar Sarda from Athena Investment. Please go ahead.

Tushar Sarda: My question was with regard to your answer to the previous question where you said the leverage is 6 to 7 times including the assignment. But in assignment there is no recourse to you, right?

Kamlesh Gandhi: So that I understand, that is the technical part of it. But I was trying to throw light on what should be the return on equity and what asset…

Tushar Sarda: I understood your calculation, the way you explained it. But if there is no recourse to you, you can leverage more, right? Because now you don't have liability for that.

Kamlesh Gandhi: Exactly. Technically you are correct but practically we have always thought that it is not recourse to us to give us the license to generate the portfolio very aggressively and leverage on a high note. So, over the period of time and going forward we would like to take AUM into account whenever we built up our assets because my assignment propensity depends upon what quality of assets I generate from time to time. Maybe it's not a drag on my capital at any given point of time but I have to behave as if it is my portfolio, it is my risk and how I'm going to work. So, leveraging at the right pace has many advantages.

Tushar Sarda: My second question was you do this lending to channel partners with these NBFCs. So in any of the books you show it as to the sectors that they have lent or it is shown separately because I don't see any lending to NBFC in the breakup that you have given?

Kamlesh Gandhi: We show it under the product that they are supposed to create from the loans we give to them. It is shown under the products. So if it is a two-wheeler NBFC and if the loan is given to generate two-wheelers product, the underlying portfolio given to the face of the two-wheeler and that is with the same aim we have given the loans to them. That's why we have categorically mentioned that of the total AUM this much portion is through NBFC distribution.

Moderator: The next question is from Dhaval Gada from Sundaram Mutual Fund. Please go ahead.

Dhaval Gada: Could you give the breakdown of the AUM under IndAS? Couldn't spot it actually in the PPT.

Kamlesh Gandhi: Break down under IndAS…

Dhaval Gada: So, Rs. 4317 crores AUM, if you could provide the segment wise breakdown on that.

Kamlesh Gandhi: I don't have a ready-made with me. I will send it across. But if you see the total AUM, there won't be much change in the GAAP numbers what we have given and the AUM numbers because Rs.70-80 crores odd difference in AUM is because of the various accounting entries that assignment income added back to the assets and all. So for the purpose of judgment you can take it as the same as what numbers you have given under the GAAP category but even though under this also I will share it with you.

Dhaval Gada: The second question is on housing. I understand the philosophy and the thought process. Just wanted to understand a bit more as to where you see this business 2 to 3 years down the line; we have steadily improved our branch presence in housing so if you could give some color as to a mature branch in 3 years' time, what kind of business that you expect it to generate, some thought some color.

Kamlesh Gandhi: So, when I met all of you in 2017 October I told you that our first target is to touch Rs. 1000 crores in the next 2 to 3 years. Our endeavor is in such a manner that we reach 1000 within next 2 to 3 years so maybe 18-19, 19-20 by 21 we should be close to Rs. 1000 crores; so the effort is on a 3 years horizon. On housing we don't take a year horizon only so on a 3 year horizon we should be at Rs. 1000 crores and on a Rs. 1000 crores base, we intend to grow anywhere between 30% to 40%. As I told you once again the markets are there, the markets are large. The only thing is that we have been more discrete in the way we work because housing once again is a leveraged business. So, going forward this will form a formidable size of our total AUM. Within next 2 to 3 years we should stay around Rs. 1000 crores and then growing at around 30% to 40% which will double our AUM every 2 to 3 years.

Dhaval Gada: What is the kind of disbursement that we do in this quarter or maybe in FY18 how much disbursements should we do in the housing business?

Kamlesh Gandhi: In FY18 the disbursements, if I talk to you from the AUM perspective where I have the ready-made number, the AUM in housing is around Rs. 209 crores which is a growth of around 18%. So, I have the figures on AUM, I will share with you the disbursement numbers. I have AUM in front of me.

Dhaval Gada: Broadly would you have some color as to how many cases do we do per quarter or per month approximately, what's your run rate that we've hit now?

Kamlesh Gandhi: If I share with you about the products what we have, we have affordable housing in town B and C categories and then we also do sort of a project funding to associate with the affordable housing developers right from day one which is converted into retail loans. So, quarterly we should see anywhere around 100 to 150 cases right now on a quarterly basis.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference back to the management for closing comments.

Kamlesh Gandhi: Thank you so much everybody and we are happy to share the insight of our business with all of you. We already have mentioned the contact number in our presentation please feel free to connect anytime for any further queries. Thank you so much.

Moderator: Thank you very much. On behalf of Ambit Capital that concludes this conference. Thank you for joining us ladies and gentlemen, you may now disconnect your lines

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