"Cholamandalam Investment and Finance Company Limited Q2 FY '24 Earnings Conference Call"

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MODERATOR: **MR. NISCHINT CHAWATHE – KOTAK SECURITIES LIMITED**

Moderator: Ladies and gentlemen, thank you for patiently waiting. Good day, and welcome to Cholamandalam Investment and Finance Company Limited Q2 FY '24 Conference Call hosted by Kotak Securities.

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 call, please signal the operator by pressing star and then zero on your touchtone phone.

I will now hand the conference over to Mr. Nischint from Kotak Securities. Thank you, and over to you, Mr. Nischint.

Nischint Chawathe: Good morning, and sorry for the technical glitch. Just continuing, we are discussing the 2Q FY '24 performance of Chola.

We have with us Mr. Vellayan Subbiah – Chairman and Non-Executive Director; Mr. Ravindra Kundu – Executive Director; and Mr. Arul Selvan – President and CFO.

I would now like to hand over the call to Vellayan for his opening comments.

Vellayan Subbiah: Nischint, thanks so much, and sorry for the delay. We will go through the key financial results for the quarter and half year.

Disbursements for the quarter was Rs.21,542 crores, which is up by 47%, and for the half year it's up by Rs.41,557 croreswhich is up by 49%. Total AUM stood at Rs.1,33,775 crores, which is up by 46% year-on-year. And net income for the quarter was at Rs.2,367 crores, which is up 39% year-on-year, and for the half year it's up by Rs.4,493 crores, which is up by 35% year-on-year.

The PAT for the quarter was at Rs.762 crores, which is up by 35%, and for the half year it's at Rs.1,489 crores, which is up by 32% year-on-year.

So, just the Board of Directors of CIFCL approved the unaudited financial results for the quarter and half year.

Just some quick highlights:

Both disbursements and AUM were robust in Q2 due to all around growth in demand.

We are seeing a pickup in replacement demand from end user segments in the auto sector, and that supported the growth for vehicle finance. The Loan Against Property business witnessed a healthy revival due to growth in demand from the SME segment, and Home Loans continue to register above average growth due to revival in earnings of self-employed non-professionals.

The new segments,SME, CSEL, and SBPL also continue to register growth, though on a smaller base.In Q2, CIFCL launched a composite QIP issue of equity shares (Rs. 2,000 crores at a price of 1,180 per share) and Compulsory Convertible Debentures (Rs. 2,000 crores at a face value of Rs. 1 lakh) overall aggregating to Rs.4,000 crores. The funds from the investors were received in the first week of October '23, and the allotment has been completed on 5th October 2023.

Some quick performance highlights:

The aggregate disbursements in Q2 we just talked about is basically Rs.21,542 as against Rs.14,623 in the same quarter, which is a growth of 47%. Vehicle finance disbursements were Rs.11,731 in Q2 as against Rs.8502 crores in Q2 of FY '23 which is a growth of 38%.

Loan Against Property disbursed Rs.3,192 crores in Q2 FY '24 as against Rs.2,246 crores in the comparable quarter of last year which is a growth of 42%.

Home Loans (Affordable Home Loan and Affordable LAP) disbursed Rs.1,575 crores in Q2 FY '24 as against Rs.743 crores in Q2 FY '23 which is a growth of 112%, and obviously the percentages is normally high because of the smaller base.

SME disbursed Rs.1,945 crores registering a 32% growth over Rs.1,473 crores in Q2 FY ‘23. CSEL disbursed Rs.2,853 crores as against Rs.1,579, which is a growth of 81%. And SBPL disbursed Rs.246 crores for the quarter.

AUM stood at Rs.1,33,775 crores compared to Rs.91,841, which is a growth of 46%.

So, the PBT growth in Q2 was at 35% and for H1 was at 31%. And the PBT ROA was at 3.2% for the quarter and for the half year was at 3.3%. ROE for the half was at 19.8% as against 18.3% in the previous year.

The Company continues to hold a strong liquidity position with Rs.11,034 crores as cash balance at the end of September 2023 including Rs.1,500 crores each invested in GSEC / T bills, which is show under investment, with a total liquidity position of Rs.13,569 crores including undrawn sanction lines. The ALM is comfortable with no negative cumulative mismatches across all time buckets.

Consolidated PBT was at Rs.1,065 crores as against Rs.762 crores, which is a growth of 40%. In terms of asset quality, Stage 3 was reduced to 2.96% as of September '23, from 3.06% as of June '23.

GNPA% as per RBI norms reduced to 4.07% as against 4.30% in June '23, and NNPA as per RBI norms has dropped to 2.59% for September as against 2.82% in June’23. NNPA is below the threshold of 6% prescribed by RBI as the threshold for PCA.

Capital adequacy as of 30th September 2023 was at 16.62% as against the regulatory requirement of 15%. Tier-1 was at 14.66% and Tier-2 was at 1.96%. Post the capital raise, capital adequacy is above 20% effective 5th October 2023.

Nischint, we will stop with that, and we will be happy to turn it over to you for questions.

Nischint Chawathe: Sure. We can start the Q&A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Punit from Macquarie. Please go ahead.

Suresh Ganpati: Hi, Vellayan. This is Suresh Ganpati from Macquarie. Let's address the elephant in the room, which is the new business loans NPLs, Vellayan, because it's gone up from 28 crores last year, last quarter from that level to 190 crores. I know there is a base effect here, but if I were to look at this number on a lagged AUM basis, it's 4%, Vellayan, it is a stupendous increase. Are you guys not worried about this pace of increase in this segment?

Vellayan Subbiah: Yes. So, two things, Suresh. Obviously just to give you a sense, there are two things happening here. One is the reporting format has changed, right? Because what used to get logged as FLDG and how we have logged kind of that's before. So, Arul, why don't you explain kind of on the?

Arul Selvan: See, the NPAs are increasing in the CSEL a little bit, but still, they are very much well within the industry norms. We have always said in the earlier quarters, the NPAs were much lower, were even lower than our secured businesses. So, that's where it will increase, but in the overall scheme of things, these NPAs are much lower, and we have already provided more than 70% for this, and the net NPAs are really much lower. So, we will continue to watch this portfolio and do this.

Suresh Ganpati: But Arul, this number is 66% of Q-o-Q, 4% on a lagged AUM basis. Are you still telling it is in line with your expectations? Because it really looks like going a little bit out of proportion.

Arul Selvan: No, it is within our expectations and within our plan numbers.

Suresh Ganpati: So, you feel these numbers have peaked or they will further go up from current level?

Arul Selvan: It may not go up. We are doing certain corrective actions with regard to the two segments as you know, Suresh. One is the fintech partnerships, and then we have the traditional line. So, in the traditional line, we are very much within control, and that is around 0.82%.

Vellayan Subbiah: Yes. So, Suresh, that's the way we should look at it, right? We should kind of break it down into two lines, right?

Arul Selvan: And the partnerships as well.

Vellayan Subbiah: Yes. The traditional line, we are at 0.82% in terms of Stage 3 growth assets. In the partnerships, the partnerships have gone up.

Arul Selvan: And the proportion of the book is the traditional line is three-fourth of the book and the partnership is one-fourth of the book. On an 8,000-crores book, we have 6,600 crores in the the traditional line, which is having a NPA of around 0.82%, and in the partnership which is the 2,200 crores, we have a NPA of around 4.7%.

Vellayan Subbiah: Suresh, your point on how we are going to react and how we are going to manage this, obviously, we are concerned on the partnership side. And obviously, we will kind of be more cautious on the partnership side, which is what has run up. The partnerships at 4.7% is the highest stage three that we have in the overall book, and therefore, we will be cautious on that and how we manage including growth on that. But on our regular, which is like Arul said, which is three quarters of our book, on our regular we are seeing a 0.8%. So, even on a lagged AUM basis, on the regular it's okay, but the partnership is what is of concern.

Suresh Ganpati: But partnership is protected by FLDG.

Vellayan Subbiah: Correct. Partnership is currently protected by FLDG, but it's still of concern.

Suresh Ganpati: But it is protected by FLDG only to the extent of 5%, right?

Arul Selvan: No.

Vellayan Subbiah: No.

Arul Selvan: FLDG will be at 5% as per the regulatory norms, but we will also have a certain hold on them with regard to continuing or extending businesses and service cost etc.

Vellayan Subbiah: So, Suresh, you are right in that the partnership business is what we are being cautious about, and we will continue to be very cautious about that business.

Suresh Ganpati: Sorry, last question on early vintage delinquencies. The recent CIBIL report talks about the fact that the early vintage delinquencies, that is delinquencies within three months or six months of disbursing of a loan really shot up in certain small ticket loans. Are you seeing that kind of a trend because the early vintage delinquencies is one of the lead indicators of the stress forming in the portfolio? Have you seen that happening in your new business norms within three or six months by default?

Ravindra Kundu: Suresh, the early default and nonstarters are under control, and this kind of delinquency in the fintech business is there from the beginning itself. Earlier the FLDG accounting was different. Therefore, that was not coming up, and therefore, that is not a concern for us, and early default and nonstarters are under normal.

Moderator: Thank you. The next question is from the line of Avinash Singh from Emkay Global. Please go ahead.

Avinash Singh: Two questions. First one again continues on that, your FLDG arrangement with the partners. So, technically, I mean, from accounting perspective, as asset quality develops depending upon the stage three, different stage developments, you will provide the credit cost and whatsoever FLDG recovery, that will come into your other income line. So, is my understanding correct there? That's number one.

Arul Selvan: Yes, you are right.

Avinash Singh: And second one is more, if you can provide some color on the yield development, not from the external factors because, of course, externally, it all depends how the interest rate are going to behave. But based on your loan product mix, growth across different channels at a different stage a bit of a product mix change that will happen over the next three, four quarters. Of course, housing typically will be slightly lower yield. Within vehicles also, the growth outlook would be different. How are you seeing sort of your yield movement due to product mix changing or setting up over the next three, four quarters?

Ravindra Kundu: See, if you see that quarter two of the last year was 13.6% in terms of total income and that has gone up to 14.3% now. So, this income has not increased in the line of the increase in the cost of fund. That's the reason there is a drop in the NIM from 7.6% to 7.4%. That is correct.

But what is happening is that in vehicle finance, we are having a marginal book yield significantly higher than the book yield of say 14.3%, maybe 15.3%. We are now acquiring the book, but the effect of the 15.3% comes with a lag, and that will start showing up after two to three quarters. So, by the end of this quarter, we will start hitting the number that used to be in the past in terms of the NIM because the income has to go up to the extent of the cost of fund going up.

Now coming to the product mix, the product mix is three types of the product mix. Within the Company, we have a product mix-up of say Vehicle Finance, LAP and other products. So, there are two type of product which we are doing it. One is fixed rate and the floating rates. All the floating rates book which is pertaining to Loan Against Property or housing loan or SME have already been increased to the extent of what is required to be done.

Now within Vehicle Finance, product mix is depending on the used and new, and now our used business has gone up to say 33% as against the 25% of the mix which used to do it in the past. So, that is going to increase the overall yield of the book of Vehicle Finance, which is at the end it will increase the total income book of Company, and it will take another two quarters.

Moderator: Thank you very much. The next question is from the line of Ashwani Kumar Agarwalla from Edelweiss Mutual Fund. Please go ahead.

Ashwani K. Agarwalla: Sir, just two questions here. How do you see the growth in the Vehicle Finance industry, especially in tractors, HCV and LCV, because we have seen very good traction in the last three, four years? And don't you think we are at the peak of the cycle for all these segments even your disbursement has gone down, has slowed down?

Ravindra Kundu: So, in tractor, if you see that in Q1 was like (-2%) growth and then Q2 has come with -6% growth, and so as of now in tractor, half yearly, we are (-4%) growth, and in the month of October also, we have seen that tractor is actually declined by 4% further. So, now we are hoping that November onwards only things will improve, but whatever it improves, it cannot go beyond say 3% to 4% of the growth in the current year or maybe it will be a flat growth.

Ashwani K. Agarwalla: What about HCV, LCV?

Vellayan Subbiah: So, Heavy Commercial Vehicle now, half yearly, it has reached to the 10% growth. Light commercial vehicles have reached to 3% growth. And in the current month, in the month of October, HCV has done very well. It has gone up 14% plus, and light commercial vehicle also has gone up. So, considering HCV and LCV and small commercial vehicle is still degrowing. In the month of October, it's a flat growth.

So, at industry level for the entire commercial vehicle as on 30th September, it has been 1% plus over the last year at the same time. So, we are hoping that the industry will be having single digit growth, maybe a higher growth up to 7%, at 8% max or between 5% to 7%, 8%.

Ashwani K. Agarwalla: So, now just one question related to this only. Out of a total AUM, more than 60% is in Vehicle Finance where growth is an issue. So, we have talked about AUM growth of roughly 25% to 30%, more than 30%. So, how is that possible with the growth slowdown in the main segment?

Ravindra Kundu: So, Vehicle Finance, if you see that the commercial vehicle grew by 1%. We grew by 6%. Our total disbursement has grown in commercial vehicle by 15%. So, a little bit market share growth of 5% plus market growth plus the ticket size growth is giving us 15% growth in new segment. But the major growth is coming from used vehicles, as I mentioned, that we are growing our disbursement mix has gone up to 34%. And there are other products like two-wheeler, three-wheeler and cars and MUV. So, put together, we have grown 35% with the help of those products.

Moderator: Thank you. The next question is from the line of Abhijit Tibrewal from Motilal Oswal. Please go ahead.

Abhijit Tibrewal: Sir, again, just briefly touching upon these newer businesses and the CSEL segment, you have already explained that a large part of it is coming from partnerships. So, somewhere during your commentary, you also said that you are taking some corrective actions. So, just wanted to understand have you made any changes in our approach or strategy in the CSEL segment?

Ravindra Kundu: Abhijit, the large part of the business of CSEL is actually coming from the traditional, which is 78%, and 22% is only the partnership. And partnership, as we mentioned even in the last quarter call also, that we are not adding any new partners as of now. We are continuing to do it, and we are also helping the partners to correct their filter so that the NCL can go down further, although it is being protected by the FLDG.

Vellayan Subbiah: Now, Abhijit, were you saying a large part of the issue was coming from partnerships or the large part of the portfolio is coming from partnerships?

Abhijit Tibrewal: Large part of the issue coming from partnerships?

Vellayan Subbiah: You're right. So, you are right. Okay. So, now what is your question around that, Abhijit?

Abhijit Tibrewal: So, sir, you were saying that you are already taking corrective actions in the CSEL segment. So, I wanted to understand, I mean, how have we changed our approach or strategy in this segment?

Vellayan Subbiah: So, there are two things like Ravi said. We are slowing down that segment, right, the partnership segment significantly. And we are also going to constantly evaluate which partners we continue to have in our portfolio, and then basically, obviously, if we are not seeing good performance on the loans, whether we should continue in those partnerships. Those are the two things, slowing down and reducing the number over time.

Abhijit Tibrewal: Sir, my last question is, maybe two parts of the question. First is for Ravi sir. Sir, how has the festive Dussehra demand been? And the second one is for Arul sir. How are we thinking about the provisioning cover on stage 3 loans going ahead?

Ravindra Kundu: This Dussehra last month we celebrated has been good for the commercial vehicle, passenger vehicle, three-wheeler, and construction equipment. The two-wheeler and tractor were actually not done well. Tractor and two-wheeler likely to improve from November month. And for the second half, we are expecting better growth in commercial vehicles as we have seen that there was only 1% growth in first half. As against that, the second half will be double-digit growth, which will help the commercial vehicle to reach between 5% to 8% as I mentioned. Passenger vehicles are growing at the rate of 7%, and the growth in the October month is also good, which is going to support to take passenger vehicle growth to double digit. So, that is the growth.

And as I mentioned that when you gain little bit more market share in the case of commercial vehicle and passenger vehicle what we have achieved now, like, for example, now we are up by 20, 30 basis point in terms of market share in commercial vehicle and passenger vehicle, our disbursement growth is coming to 20%, and the additional growth which is coming up to take the overall growth to 35% is being met by the two-wheeler, used vehicle,three-wheeler and construction equipment. And so, what is your second question?

Arul Selvan: It is on the provision coverage.

Arul Selvan: So, provision coverage, as you would have seen, Abhijit, that has been improving, and we are now at around 47%. My view, it will hover between 45% to 50% as we move forward in the next few quarters. It will depend on the PD, LGDs and the product mix.

Moderator: Thank you. The next question is from the line of Prashanth Sridhar from SBI Mutual Funds. Please go ahead.

Prashanth Sridhar: So, the yield in these new businesses seems to have gone up significantly from 22% to around 27%. One, if you can explain this? And now that you are being conservative, should we expect this to go down?

Ravindra Kundu: No, see, so what we are saying is that in the case of the partnership, which is 1.5% of the total portfolio, we are actually evaluating the partner where NPAs are higher. So, in spite of we are basically protected, we are guiding them to ensure that their filters are tight. So, not that 1.5% disbursement will go down and it will impact the overall yield.

Vellayan Subbiah: No, but I think his point is the yield is going up. He is saying the yield is going up in those businesses. How much say the yield moved up? So, is your concern that the overall yield will come down if we slow down the partnership business or you are saying that the yield in the partnership business has gone up?

Prashanth Sridhar: No. So, I am saying that the total yield in the other businesses seems to be increasing, and now that you plan to be conservative, where should we sort of expect the average yield in this business to stand up?

Vellayan Subbiah: Again, right. I think you are over indexing on the fact that, see, like we are saying, our total partnership portfolio is at Rs.2,000 crores. Okay. That's Rs.2,000 Cr on an AUM of Rs.133,000, which is about 1.5%. So, definitely kind of us slowing down in that business is not going to affect overall yields or swing overall yields at all. Right? So, I think if that's your question, then that is the response. That's the answer.

Prashanth Sridhar: So, the yield on the other business you would expect at around 25%, 26% on average. Is that fair?

Vellayan Subbiah: No, I am just confused where you are getting your yield data from? Because we have not shown any yield.

Arul Selvan: Income at the Company level is around 14.3% and which is increased from 14.2% in the previous quarter, that's Q1.

Ravindra Kundu: And that will go up only vehicle finance mix.

Arul Selvan: It will go up, Yes, only because of change in vehicle finance mix.

Prashanth Sridhar: Now maybe if you can just help us, so in the other businesses, how would the yield have moved in the last two or three quarters?

Arul Selvan: The other businesses we have not yet started disclosing the yield and the line items. As we said, we will disclose from next financial year.

Vellayan Subbiah: That's directionally we can tell.

Ravindra Kundu: No, here actually the page number, if you go to the loan against property page number, the yield is given, 11.7% to 12.7%. So, there is a increase in 100 basis points.

Vellayan Subbiah: You are asking for new businesses or what are you asking?

Prashanth Sridhar: Right. New businesses.

Arul Selvan: So, the new businesses are a mix of two different one certain high yield businesses like CSEL and SBPL, high yield but low volume. SME, high volume but low yield. So, it's a mix, and it will all come to the similar levels of around 14% if you consider it. We will start disclosing this from next financial year. I think till that time independently, each business is, we are not disclosing.

Prashanth Sridhar: So, the way we arrived at it is, so you have given the gross income on Vehicle, LAP and Home Loan, and we have the total. So, I am just taking the balance as others and then taking it as a percentage.

Arul Selvan: See, this is the same mistake even last time somebody did with regard to the provision.

Prashanth Sridhar: Credit cost.

Arul Selvan: There is also a treasury income there. So, don't assume that all of the rest of the income is only from the new businesses. Treasury, we have a transfer price model. Anything beyond the transfer price is considered as treasury income. So, I think kindly wait for us to disclose the details before getting trying to get this arrived at.

Prashanth Sridhar: And out of the 13, 8 I think is CSEL. How was the NPA on the remaining business? Anything over there for us to worry about?

Arul Selvan: Actually, SBPL volume is so small. It's around 0.15% or something. SME is 1% and SBPL is 0.2%.

Moderator: Thank you. The next question is from the line of Abhinav Anchal from SBI Life. Please go ahead.

Abhinav Anchal: I have two questions. One, when we are showing the segmental information, we are seeing a decline of 20 to 25 basis point in cost of fund across the three lines, but the Company level, the cost of funds are flat. So, can you help us understand what is happening when we are showing the segmental cost of fund?

And the second part is that we are seeing a very strong traction on the used vehicle side, almost 10% sequential growth in disbursement. So, can you give us some color on the used vehicle category that which class of vehicles we are financing? What is the vintage of vehicle we are financing? And what is the outlook here for, let's say, the next couple of years?

Arul Selvan: Just the first point I will answer, and I will request Ravi to give you the second point. First point is the pricing to the individual businesses goes based on a transfer price which is declared at the beginning of the month. So, the transfer price we will be giving based on what is the treasury's assumption in the market. So, that is the transfer price, and between that and what is really incurred, there will be some differences, which goes into the treasury P&L as well as the other investments.

So, whenever we have surplus funds because we are holding cash for LCR purpose etc., those things are investment income that comes into the treasury income. So, these are the ones which get into treasury income. So, that transfer price from that is the cost of funds what you seeing in the segmental is basis that transfer pricing. So, that will be difference. So, overall cost of funds reported for the Company is the actual cost of funds incurred by the Company. I will request Ravi now to answer the used vehicle’s part.

Ravindra Kundu: Used vehicle we mentioned in the past that we will be focusing on that, and this year is a market of the used vehicle because last year new vehicle purchased went up, and then now people are selling their vehicle, and then the replacement demand will pick up, and that will help the industry to basically see new vehicle also getting sold.

So, the used vehicle is coming from HCV, LCV predominantly, then followed by passenger car and then used tractor and used construction equipment. All put together it is 34% of the total disbursement close to say 1,400 crores, and these businesses are going to go up only, and the growth momentum is very good, and it is going to be maintained in this way.

Now we have always clarified that we have been doing the business of used only for the vehicle which are less than 10 years. The major vehicle which are coming to us for buy and sell or refinance are 5 to 10 years old vehicle.

Moderator: Thank you. The next question is from the line of Shweta Daptardar from Elara Capital. Please go ahead.

Shweta Daptardar: I just have one question. So, this quarter we saw credit costs around 1.3%, and given the fact that there has been additions to NPA from the new business segment, you also mentioned we raised the PCR there. What is the normalized credit cost for the overall book going forward?

Arul Selvan: We had already indicated that in earlier calls that over the cycle we would be in the range of around 1%. So, maybe this year we may land up slightly higher at around 1.1% or 1.2%, but we expect in Q3, Q4 good traction on the vehicle finance and other portfolios to reduce this percentage. And CSEL should be in the range of around 1% to 1.2% this year.

Shweta Daptardar: And just one question, I just want to confirm. So, did you mention CV volume growth to be 8% for the full year FY '24?

Vellayan Subbiah: What volume growth?

Shweta Daptardar: CV volume growth. What is that 8% growth in CV for full year FY '24?

Ravindra Kundu: That is the industry. We have mentioned that industry is likely to grow in single digit because as of now, growth is 1%. So, it will improve over the period in the second half, and it will go between 5% to 8% is our expectation.

Shweta Daptardar: So, that's for volume growth, right, for the full year? The industry volume growth?

Ravindra Kundu: Yes.

Ravindra Kundu: Industry number growth.

Moderator: Thank you. The next question is from the line of Saptarshi Chatterjee from Groww AMC. Please go ahead.

Saptarshi Chatterjee: Sir, if you can give some ballpark indication what would be ROTA for the new businesses? And if someone, like if we assume that like ROTA as you have said earlier that the ROTA for the new business is higher than the Company level ROTA, then if I see pre-COVID also, pre-COVID we are making around between 3.1% to 3.5%, 3.6% ROTA.

So, now if we see after like new businesses have now around 11% of our AUM still lower, but we have achieved some bit of diversification, but our ROTA has not improved much, and going forward like one can expect only credit cost to move up from here as the book matures. So, I wanted to know your perspective like whether the structural ROTA improves as we grow our new businesses, or it will be remain in the similar line?

Arul Selvan: So, the comparison between COVID period and now, there are two important elements. The cost of funds was very low, and we had also passed on some benefits on the yield, especially with regard to the Vehicle Finance book we spoke about it where we cannot correct the yield on the fixed rate book. So, that correction will happen. So, that is going to be NIM accretive, and therefore, ROTA accretive.

Our expectations are we have sort of bottomed out on the on the cost of funds. So, here onward, there should be a reduction in the cost of funds. So, that should also be NIM accretive. I am not wanting you to build too much expectations on that, but this could be in the range of around 5 to 10 basis points from each of them contributing.

The credit cost will come lower. If you again go back to pre-COVID, you will always see Q1 and Q2 are the quarters, especially in Vehicle Finance, where you will see higher credit costs because these are months where activity levels are much lower, especially for vehicle operators, and they tend to have better earnings in Q3 and Q4 where we will have better traction in collecting overdues as well as regular EMIs. So, that's where I am giving when I spoke on the earlier question also, it is from current 1.3%, it will come down to 1.2% or 1.1% is the overall credit cost we are expecting.

So, we are confident of keeping the ROTA at around 3% to 3.5%, which is what we always say that we are endeavoring to reach out, and we are confident that this year also we will reach 3.5%.

Saptarshi Chatterjee: And any ballpark like indication that you can give on the new business ROTA?

Arul Selvan: No, I told again in the earlier questions that the new businesses breakup, we will start disclosing from next year. So, we will do that. Kindly wait.

Saptarshi Chatterjee: Understood, but still like even if those are higher, but we still remain around 3% to 3.5% ROTA.

Arul Selvan: It's not our indication, sir, it is like there are new businesses which are lower yield or lower ROTA like SME businesses, and there are other businesses. So, we will have to wait and watch.

Ravindra Kundu: The SME business is lower than the overall Company ROTA, and it is going to be like that only, and our CSEL business and SBPL businesses will be much higher than the Company ROTA what we are delivering as of now, but it will take time because we need to leverage. We have invested in that in terms of people, and once the AUM goes up, then we start gaining that kind of ROTA, and it will take another 6 months to one year time.

Saptarshi Chatterjee: And just one clarification. This quarter we are seeing that the employee cost growth has been Q-on-Q very high even on Y-on-Y basis. Any one-off in this?

Arul Selvan: We moved a lot of people who were under an off-roll arrangement into our own employee cost. So, you will see some reduction in other costs and employee costs going up. If you compare both together and consider the increase in AUM as well as normally the increments and promotions happen in Q2. So, there will always be some increase on account of that. Factoring in all that, that's what is the reason for this variance. Over the next two quarters, you will see this difference between employee cost and other cost.

Moderator: Thank you. The next question is from the line of Bhavesh Kanani from ASK Investment Managers. Please go ahead.

Bhavesh Kanani: Going back to the fintech partnership where we are looking to take corrective actions, just wanted to understand the manner in which the entire arrangement is structured. That is, I am sure we would be giving them certain filters of the kind of loans we want to source through them, and on top of that, they would be doing their own evaluation. How does it work really in terms of exact or specific aspects of the arrangement when it comes to underwriting aspect with partnership model?

Ravindra Kundu: All the fintech partners who actually start proposing the norm, then it actually goes through our underwriting team and also our Risk Head evaluates the same. Then we approve a filter which is acceptable to us. Then after getting the early default and non-starter, we start recommending to basically tighten the credit so that further the early default non-starter can come down, and that is what we mention that wherever there is a slight increase in the NPA, we are trying to basically reduce it by increasing more filter.

And that is the continuous process because one is that the in the partnership, they come with the FLDG, but secondly, we have to also ensure that we should not depend on only FLDG, but our NPAs are lower. So, our endeavor is to basically provide data analytics and risk department services to them to ensure that they end up sourcing good quality proposals. That is one side.

Second is that we also review their collection mechanism, like, for example, what is current roll forward, and then what is the roll forward in the subsequent bucket. We identified that their current, their entire focus of these fintech partnerships in the current only. They are able to basically do much lower roll forward or higher collection efficiency in the current, but when it comes to the roll forward from the bucket one to higher bucket, they are not able to put that kind of effort. So, we are helping them to increase the collection efficiency in higher buckets so that the NCL can come down. So, that is also the services we are providing as a guidance to them.

Bhavesh Kanani: And you shared that the GNPA levels for the fintech book is about 4.7%, and we are still considering that is within the original expected levels. At what level would you kind of reconsider this entire fintech as a root of origination? What level of NPA would trigger that kind of reevaluation?

Vellayan Subbiah: No, I think we have already discussed that we are basically obviously, we are evaluating and slowing down. So, kind of obviously, even at this level of people continue. We won't be basically growing Partnerships that are basically contributing to NPA at these levels.

Moderator: Thank you. The next question is from the line of Kaitav Shah from Anand Rathi. Please go ahead.

Kaitav Shah: Mr. Vellayan, this question is to you. Essentially, since you are the largest shareholder, do you see this business in terms of risk given that we are hearing a lot about smaller ticket size loans turning bad? Do you think that you will be easing off sometime in terms of growth or you are comfortable in terms of the data that you are seeing coming from your own Company?

Vellayan Subbiah: Are you talking about partnership loans? Are you talking about the overall?

Kaitav Shah: No, sir, just general.

Kaitav Shah: Overall, not the partnership loans.

Vellayan Subbiah: But overall, maybe I am trying to understand the question, because obviously, overall our book does not have a lot of small ticket personal loans, right. And overall, our book is 60% focused on vehicle, and we got 20% on loan against property. So, I am just trying to understand, overall, over 90% plus, our portfolio is secured lending, right. So, I am just trying to understand the nature of the question.

Kaitav Shah: So, the nature of the question is in the fact that is the problem kind of just isolated to partnerships and the other business aspects are doing fantastically well? Do you see this kind of continue? Are you also looking at risk now more closely than, let's say, a year ago is kind of across the other businesses as well?

Vellayan Subbiah: So, I mean, obviously, we have and continue to monitor risk in all of our businesses, and I don't think anything changes there. And you know, I would say that we have fairly matured and well-developed systems that we continuously improve on. So, we are continuously working on what we can do for vehicles, what we can do for LAP, what we can do for housing loans to improve credit models, underwriting models' collection models, all of that, right. And so that process continues, and our analytics capability, and that only gets me more and more confident overall about the business for us going forward.

I think the specific question, and I understand that there have been questions, quite a few questions relating to our partnerships business. We are obviously kind of looking at that and looking at what kind of corrective action we want to drive in that business, but overall, I would say that my confidence level is very high because we see good growth from the other sectors, good performance, and significant, I would say, even medium to long-term growth opportunities in those segments.

Moderator: Thank you. The next question is from the line of Umang Shah from Kotak Mutual Fund. Please go ahead.

Umang Shah: Just one question from my end. Now in the past also, the management has discussed, right, some of these new businesses will take some time to stabilize, and by nature itself, they might have slightly higher NPLs on the face of it. But my question is that, should we assume that on a long-term basis the headline NPA and the credit cost number might look a little elevated, although we might be able to deliver the kind of ROAs and ROEs that we are looking at the overall consol level? Is that the right understanding?

Arul Selvan: See, that is the whole point of the diversification, right, Umang, because we will have books which will run at much lower credit cost, and we will have some book which will run at a slightly elevated credit cost. And they will also change the quantum on the percentages over cycle, and the well diversified book helps us to manage this and keep it within the target as I was telling you earlier in the 1% to 1.2% range. I think we still hold that, and we are confident that we should not cross that.

Vellayan Subbiah: So, Umang, the answer to your question is no, we don't think it's going to kind of increase out of this range.

Moderator: Thank you. The next question is from the line of Preethi RS from UTI AMC. Please go ahead.

Preethi RS: My question is on the asset quality in Vehicle Finance. If you look at the provisions, it is trending at around 1.6% for the first half which is higher compared to pre-COVID trends, and even the gross stage 3 on absolute basis is higher by 17% compared to March '23. And if you do some back calculation, it suggests we have written off Rs.400 crores on an overall portfolio basis. So, which segments within Vehicle Finance are contributing to new slippages?

Ravindra Kundu: See, Vehicle Finance, first of all, from June to September end, if you see that, our NPAs are flat. It is 3.35% to 3.32%. In absolute value, it has gone up by Rs.100 crores, but provision has gone up by almost Rs.100 crores. So, that is the additional provisioning we are creating for the higher bucket from this financial year. You would have heard that RBI is talking to every Finance Company to improve the provision coverage. So, we have brought some one particular norm which is over and above the ECL and that is the reason for the higher NPAs for this.

First quarter and second quarter is always the lean period for the vehicle finance. Especially in September this year, it was fully raining as against the August was dry. So, little bit collection did not happen in the month of September as it was expected which is going to happen in the 3rd **quarter.** Last year, if you see that, our numbers are much lower from the Q1 to Q1 and Q2 to Q2 and H1 to H1. And we are expecting that we have closed the number close to 1%, 1.2% and with the help of the Q3, Q4 performance, we will reach to the level.

Preethi RS: So, is it fair to say it's the tractor segment with the vehicle finance?

Ravindra Kundu: No, it is not a tractor segment alone. It is all across segment, across the markets there is no concentration with respect to geography and the product.

Preethi RS: And could you confirm if the write-off number is right for the Q2? What is the write-off number for H1?

Ravindra Kundu: H1 write-off number. One second. Just hold on. H1 write-off numbers are actually similar to what last year's number.

Ravindra Kundu: Actually, it is lower by 100 crores. Last year it was 500 crores. Now it is 400 crores.

Preethi RS: 400 crores, okay.

Arul Selvan: It is the Company level.

Ravindra Kundu: That is the Company level and even Vehicle Finance also is lower.

Arul Selvan: It is 110 crores. Most of it comes out of H1.

Ravindra Kundu: 110 to 89 crores.

Arul Selvan: Yes.

Moderator: Thank you. The next question is from the line of Kunal Shah from Citigroup. Please go ahead.

Kunal Shah: So, the question is on OPEX. So, even if we do this adjustment in terms of outsource agent off-roll, but still at the overall OPEX level, the sequential rise seems to be quite high. So, where do we see OPEX to assets and we see across the segments, not particularly across the cost to assets have actually gone up. So, what would be the outlook on that? And if you can just share the number of employees who have now been on the on-roll because it doesn't seem to include in this 51,000-odd employees which we you have?

Arul Selvan: No, we still keep it at the 3% average asset level. That is what is our stated and we are confident we should be within that as we close the year, this year. This quarter's increase is because of the increments that normally happen in Q2 because all our employees get their annual increments as well as promotions effective from July. So, you have the full hit of that comes. That is one thing, as well as there has been incremental people…

Ravindra Kundu: And all incentives are also accounted for in this quarter.

Kunal Shah: So, ex of employee overhead also seems to be high if we adjust for this transfer. Okay. So, no doubt it's a decline, but if we just…

Ravindra Kundu: Yes, there is a disclosure on the number of employees also.

Kunal Shah: So, that includes off-roll now?

Vellayan Subbiah: It's ex of employees. He is saying the other average.

Arul Selvan: Other average is because branch expansion is there and other average has not moved that much. You can see that.

Kunal Shah: And off-roll to on-roll, what would be the?

Arul Selvan: That is what is the reason for the shift between employee cost and other expenses. So, you look at it together and take out the employee cost across three comparative quarters we are doing. Either it is q1 of current year or the Q2 of previous year. You will see that there is a manpower increase of around 12,000 numbers plus I am talking Q2 of last year versus Q2 of this year plus that increase in head count plus the cost increase because of the annual increments and then if you come back the outsource movement from off-roll to on-roll is the shift in line item, not shift or increase in cost.

Kunal Shah: And this 51,000 doesn't include off-roll which we have disclosed. We have 50,980 that doesn't include.

Arul Selvan: That includes off-roll.

Kunal Shah: So, it's not more than 2,000.

Arul Selvan: Yes.

Moderator: Thank you. The next question is from the line of Nidesh from Investec. Please go ahead.

Nidesh: Just two questions. First is on what is the comfort level of unsecured exposure on AUM basis that we have from a medium to long-term perspective? And second is, if I look at yields on the housing loan segment, these are quite high at 15% plus. Most of the affordable housing finance companies we track are operating at around 13% yield. So, how should we think about the sustainability of yields and profitability in the Housing Finance business?

Vellayan Subbiah: So, unsecured 10% is what we would kind of view our comfort level over the next two years, right, kind of not saying that we will grow there, but if you are asking for a cap, then that is a cap.

Ravindra Kundu: And in the affordable housing, as you know that now we started moving from South to other market, smaller market where tier two, tier three, tier four pricing are slightly higher than the normal and that need to be maintained because to that extent we need to check whether what kind of risk is there. So, we have priced it slightly higher than that in the smaller town, and that's the reason the overall yield has gone up, and also yield has gone up because of the rate reset as well.

Moderator: Thank you. The next question is from the line of Piran Engineer from CLSA. Please go ahead, sir.

Piran Engineer: I am just referring to your sector outlook on Slide 33. What really makes you cautious on HCV and SCV at this juncture? Especially for HCV, you mentioned increase in operating cost. So, just wanted to understand that better.

Ravindra Kundu: In heavy commercial vehicle, actually that for us, the problem is that if our cost of fund is high, we don't participate in, and SRTOs are not able to participate because there is a formalization happening in the heavy commercial vehicle business.

That is what we are trying to mention that our exposure as of now is 7%, and we are trading carefully in this segment due to the increase in price and operating cost of the vehicle. Because the cost of vehicle goes up, then our customer segment is not in position to acquire the vehicle and operate that. Because our customers are Small Road Transport Operators, they don't have the contract of the load, and they need to look for the load, and therefore, the productivity goes down, where in the captive and mix size or a large fleet operator, they have a contract, and therefore, they can manage in spite of the cost of vehicle going up.

Piran Engineer: No, but why do you say operating costs are up? Because fuel prices have been, which is the largest cost. Fuel and toll are the big costs. I don't know about tolls, but fuel prices have been stable now for more than a year.

Ravindra Kundu: Driver and cleaner cost, maintenance cost, then the insurance cost, all those costs are also going up significantly. Fuel cost is constant, but rest of the cost are also gone up.

Piran Engineer: And just quickly on your other income which used to be like 40, 50 crores per quarter, now last two quarters it's been tracking more than 100 crores. This time 140. Can you just give us a sense of what exactly is included in this other income?

Arul Selvan: This quarter, there is a dividend income into it. We have given that in the notes if you can see that. Normally, the other income should be in the range of around 30 to 35 crores. 40 crores, Yes. Last quarter we had the FLDG coming into this, which was the largest number. This quarter it's not to that extent. It is much lesser, but there is a dividend income coming. This will stabilize into the 40, 50 crores levels.

Piran Engineer: I would have missed that.

Moderator: Thank you. The next question is from the line of Bhaskar Basu from Jefferies. Please go ahead.

Bhaskar Basu: Just two questions. I think one you partly clarified. So, on these variable commission structure with FinTechs etc., is the variable fee or commission netted off in the yield level, and so to some extent is that FLDG or quasi FLDG embedded in the yield? That was number one.

And secondly, if you look at your unsecured portfolio, which is about Rs.8,000 crores, I think you talked about Rs.2,000 crores being fintech partners. So, as you kind of calibrate your fintech book, what are the steps you are taking? Do you expect the whole book to slow or are you building or you taking any steps to kind of build your traditional channel so that the growth there continues to sustain? Yes, these are the two questions.

Arul Selvan: See, there is no variable commission and all. What happens is, the share of yield is differentiated based on the portfolio, based on the FLDG, based on the volumes. So, many factors run into it. So, what is the ultimate yield and what is the share the fintech partner retains and what is the share they share with us. So, this will change from partnership to partnership, and this cannot be disclosed as confidentiality with all of them, and we also don't want to disclose these things right now. So, that is what is there over and above the FLDG, which will protect us. Correct?

Ravindra Kundu: As far as the mix is concerned, as you mentioned is right, that 75% is basically a traditional book and 25% is partnership book, and in the partnership, as you asked that what are we doing? Out of the 10 or 12 partners we have today, there are few partners we have seen that there is a requirement to calibrate their underwriting now to reduce, but at the same time the others are doing well. So those who are doing well, we need not just reduce their number. And probably, they might increase also.

So, what we are saying is that, as of now, we are focusing more on traditional to increase our share of 75% to higher than 75%, but that doesn't mean that the 2,000 number will go down, and 2,000 number is actually going to be maintained as it is, but is coming from the better partner who are having a good quality and lower NCL and lower NPL.

Bhaskar Basu: So, just a clarification there on the first part. What I was referring to is performance related commission where there is a whole structure wherein kind of the commission is linked to performance of the portfolio. So, I was basically referring to those. I mean, FLDG is very clear, I think.

Arul Selvan: It should be there earlier, but now we don't pursue that part.

Bhaskar Basu: And so FLDG is now reflected in the other income is what I understand, right?

Arul Selvan: On write-off, it will be reflected. Till then, it will be outside the book because we keep providing for the book, and once we know that, like either it crosses 90 days or 180 days or we get a confirmation that this is not collectable, then we invoke the FLDG, and the moment FLDG is received, we show it as income there and show it as write-off here in the NCL line.

Moderator: Thank you. The last question is from Nischint from Kotak Securities. Please go ahead.

Nischint Chawathe: My question actually pertains to the release that you have done to the exchanges on the family arrangement. Now without getting into the specifics, because it's a family matter, but just curious, is there any implication for the listed Company and its shareholders in terms of the shareholding pattern changing or any changes in management or anything of that sort that listed shareholders need to be aware about?

Vellayan Subbiah: Nischint, I think we have clearly stated in the statement itself that there is no impact to listed companies or the shareholders. So, just to give you a sense, the transaction is fairly simple in that we have a holding Company which is Ambadi Investments Limited that then holds equity in all the underlying kind of companies of the group, right. And that family member owned a percentage of Ambadi Investments Limited which we have now basically effectively bought back from that family segment, right.

So, basically, now, the only transaction is in the holding Company where all the rest of the members of the family continue to hold equity in the holding Company, and we brought back her portion of it. I mean, that not hers, but her segments portion of it. So, there is no implication for anything else in public companies and no implication for other shareholders at all.

Moderator: That's very reassuring. That was the last question for today's call. So, thank you everybody for attending this call, and thanks a lot to the management for giving us an opportunity to host this call.

Moderator: Thank you. On behalf of Kotak Securities, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.