IIFL Finance Limited
(formerly IIFL Holdings Limited)

Consolidated Financial Results – Q3FY20

Conference Call Transcript
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Management
Mr. Nirmal Jain – Chairman, IIFL Finance Limited
Mr. Sumit Bali – Chief Executive Officer – India Infoline Finance Limited
Mr. Prabodh Agrawal – Chief Financial Officer, IIFL Finance Limited

Moderator: Ladies and gentlemen, good day and welcome to the IIFL Finance Limited Q3 FY2020 Earnings conference call.

I now hand the conference over to the management. Thank you and over to you, Sir!

Prabodh Agrawal: Good afternoon, everyone. On behalf of team IIFL, I thank all of you for joining us on this call. I am Prabodh Agrawal, CFO; accompanied by Nirmal Jain, our Chairman; and Sumit Bali, CEO of IIFL Finance. I will now pass the mic to our Chairman to comment on overview of the strategy and plan

Nirmal Jain: Thank you, Prabodh and welcome to all. So normally as I speak about macro environment and then how our group strategy fits into that. The economic growth and the macro headline numbers are still challenging, they are not what we all would like them to be, but all hopes are pinned on the budget and we can hope that government is committed to make sure that the economy is back on growth path, and all the sectors, all the segments be revived. Coming back to IIFL Finance and the credit market that we operate in, the positive thing is that the lending capacity has decreased for the system as a whole and therefore, I would say that in the core segments that we operate in, the competitive intensity has eased or has become more sober. In fact, if there are too many me-too players and new players, the market becomes a little more challenging, I mean to take example of loan against property market where the rates have gone down, without factoring in the risk premium. So, all the core segments that we work in, the operating environment seems to be much better and that is reflected in our results as well. So, our strategy remains the same as we had articulated earlier. In terms of growth, we want to focus on retail, small-ticket, granular loans, so incrementally, we are focusing on that and those loans now are almost about 87% of our portfolio, the remaining 13% primarily, developer portfolio, in fact, a lot of apprehension about this portfolio, but I said this earlier and I reiterate that, at least our developer portfolio is not in the high priced segments of Mumbai where there is a supply overhang and many large-scale projects are not selling or they are stuck for end-user demand. Almost entirely our development loans are in suburbs of Mumbai or NCR or in smaller towns and cities, each and every project is monitored very carefully and we are also working on whether the entire or a significant part of this portfolio can be transferred to an alternative investment fund. IIFL asset management company, which is part of our wealth has shown interest and a diligence has started, but there will more information on this as we go along.

Having said this, in terms of retail business model, we are focused on using technology to leverage growth without increasing operating costs and that is why even in this turbulent time of last 15, 16 months, we have been able to maintain our net interest margin and our return on assets. In the last quarter, we have seen that the volume growth in core segments of our business is coming back, and we are seeing that the outlook for this quarter is even more optimistic and as we get the business volumes back, I think even the margins will improve, particularly in businesses like home loans, where our fixed cost structure, we are not able to stretch it fully because of lower disbursals in the last 9 months, but I think as we go along, the environment is improving. Significantly for us, National Housing Bank has reduced the interest rate, which will allow us to be more competitive in the home loan segment, which is more price sensitive.

Now, I will hand it over to Prabodh, our CFO, to take you through our financial numbers in greater detail. Thank you.

Prabodh Agrawal: Thank you, Nirmal. IIFL Finance net profit was Rs192 Cr in 3QFY20, up 11% QoQ and 77% YoY, excluding the one-time impact of reversal of deferred tax asset in Q2FY20. Loan AuM grew 11% YoY and 3% QoQ to Rs36,015 Cr, excluding CV business AuM, which was divested in 4QFY19. Our Tier-I CAR stands at 17.9% and total CAR at 21.4%. Primary drivers of our AuM growth are small ticket home loans, which grew by 10% YoY, Gold loans, which grew by 41 %YoY and Micro-finance loans, which grew by 70%YoY. On the other hand, the share of developer and construction finance, LAP and Capital Market loans continue to decline. In home loans, our focus remains primarily on small-ticket loans to the salaried and self-employed sections. The fastest growing segment in home loans is the affordable home segment, or Swaraj loans, with average ticket size of INR 13-14 lakhs. IIFL Home Finance has been a significant player in PMAY-CLSS. Till date it has provided benefits to 34,000 customers and disbursed subsidies of nearly Rs.800 Cr. Retail loans, including consumer loans and small business finance constitute 87% of our loan book. Another strong characteristic of our loan book is the large proportion of loans that are compliant with RBI's priority sector lending norms. About 61% of our HL, 48% of Business loans and 92% of our MFI loans are PSL compliant. In aggregate nearly 44% of our loans are PSL compliant.

Some details on the profit and loss account: Our interest income comprises of gross interest earned on loan assets and spread earned on assigned assets. Loan assets include securitized assets. Net interest income on loan assets has gone up by 5% QoQ and declined by 13%YoY. Net interest income on assigned book has declined by 5% QoQ and gone up by 118%YoY. This is broadly in line with QoQ and YoY growth in loan book and assigned assets. Our NIM for the nine month period was 8.2%. Excluding the 2% spread on assignment, the normalized NIM was 6.2%. Our average cost of borrowings fell by 9 bps QoQ and rose by 39 bps YoY. The other income of Rs66.9cr comprises of interest strip i.e. upfront amortization of interest on assigned assets of Rs21cr, fees & commission income of Rs26cr and other income of Rs19cr. Interest strip in this quarter is lower compared to previous quarters, as the volume of new assignment was lower. Operating expenses are flat QoQ and up 11%YoY due to increase in the number of branches, employees and related overheads. The number of branches has increased by 27%YoY to 2,366 as we added new branches for our microfinance and gold businesses. The number of employees increased by 9%YoY to 18,309. The operating expenses were flat QoQ as our headcount and the salary costs are slightly down QoQ. We were also able to cut down several discretionary expenses like marketing & advertisement and traveling expenses. Loan-loss provision at Rs34.8cr were down 77%YoY and 42%QoQ. Effective tax rate for the quarter was 22.6%. For the 9m period it was 23.5% versus 9m last year of 33.4%.

The OCI or other comprehensive income shows a gain of Rs4.3cr, which is a partial reversal of the previous quarter's marked-to-market loss of Rs12.7cr on our foreign exchange loans. As the foreign exchange loans are fully hedged, both principle and interest, this is just a notional gain/loss, which will be eventually nullified. We completed securitization/assignment transactions amounting to Rs2,381cr in Q3 compared to Rs 3,721 Cr in Q2 and Rs 4,595 Cr in Q1. We sold down both PSL and NPSL loans in five product categories including HL, LAP, SME, Gold and Micro-finance, to government, private and foreign banks. Access to long-term funding has significantly improved this quarter. We raised long-term loans to the tune of Rs2,721 Cr in this quarter, compared with Rs403 Cr in Q1 and Rs1,723 Cr in Q2. Our funding mix is well diversified including 22% from NCDs, 36% from bank term loans, 4% from NHB refinance and 38% from securitization and assignment. Our Asset-Liability maturity is well matched with surplus in all buckets. Consolidated GNPA was at 2.27% of loans and NNPA at 0.98%. This was a significant improvement over the previous quarter's GNPA ratio of 2.51% and NNPA ratio of 1.51%. Provision coverage, including on standard assets, stood at 95.4%. Return on assets for 3QFY20 was at 2.5% and return on equity at 16.8%.

For the 9m period ROA was 2.26% and ROE was 16.3%, excluding impact of one-off items. IIFL Loans app's popularity with customers is increasing, customers are increasingly using it for payments and top-up. This quarter we had 1,22,600 avg monthly active users on the app. We have improved the customer experience on the app; we have high ratings of 3.9 on Android Play Store and 4.4 on iOS App Store.

Thank you. We will now open the floor for Q&A.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Anitha Rangan from HSBC Asset Management. Please go ahead.

Anitha Rangan: Good afternoon. The first question I had was, you had said that you had raised about 2300 Crores through assignment and securitization, but your overall assigned book is like flat, so can you explain how this works?

Nirmal Jain: We raised 2300 Crores by long-term debt, which is bank loan and nonconvertible debentures, bond, so that basically is borrowings.

Anitha Rangan: No. This is securitized assigned loans of 2381 Crores?

Prabodh Agrawal: Yes. Okay. So, the thing is that we had new assignment securitization of 2381 Crores in this quarter, but there is also a rundown of the existing book, so the net impact is that Q-on-Q, it is almost a flattish kind of off-balance sheet book.

Nirmal Jain: So, the earlier securitization asset would have got paid off as the customer pays back the money, it goes back to the banks, so the assets go down.

Anitha Rangan: So, this like around 2300 Crores is like the quantum, which we can see like maturing every quarter is that what we understand?

Nirmal Jain: Next quarter also, it will be similar number, yes.

Anitha Rangan: Also, in your housing segment, can you explain like what kind of customer profile you will have at a yield of like you say 11%?

Nirmal Jain: No, 11% is a weighted average yield. Profile of customers, every ticket size is Rs.16 lakh to Rs.18 lakh almost there is a 50-50 split, but now it is more increasing towards salaried people, which is slightly more than 50%, so these are maybe government employees or people in smaller towns, places like Nashik, Nagpur or Bhuj, or maybe in Virar or Panvel or Thane or these kind of places is there where we operate, so most of these can be either self-employed traders, businessmen or salaried people that is the profile of people that you will have. I think, typically, they will be Rs.6 lakh to Rs.8 lakh or Rs.6 lakh to Rs.10 lakh income range.

Anitha Rangan: Just one more question on your loan loss provision of this quarter, are there also any write-backs, which you have taken this quarter, but as compared to Q3 of FY2019, it is quite small, just trying to understand that?

Nirmal Jain: Yes, so in normal course, there are write-backs and write-offs. So there are recoveries and therefore, there can be some write-backs, you are right.

Anitha Rangan: So, there is like a substantial write-back in this quarter, we can understand?

Nirmal Jain: I do not think it is substantial, but there will be some write-back.

Prabodh Agrawal: So, there will be some write-back, if an account is upgraded from, for example, say, from stage 2 to stage 1, from SICR to stage 1, there will be some write-backs, so that has happened in some cases.

Nirmal Jain: But the provision this time is less not because of write-back alone, new slippages were also low.

Anitha Rangan: So just one more thing, when I am trying to see your results, which you have posted in BSE, the financial results, the impairment on financial assets is like a positive 35 Crores and there was a line item called net loss on derecognition of financial instruments. i.e. Under expenses category, there is a third item called net loss on derecognition of financial instruments, which is like 49.38 Crores, and then there is also another line item called impairment on financial instruments, which is a positive 35.82 Crores? so just trying to reconcile what those items would be in this, within the loan loss provision?

Nirmal Jain: We will get back to you on this.

Anitha Rangan: Sure, alright. Thank you very much.

Moderator: Thank you. The next question is from the line of Rajeev Agrawal from DoorDarshi Advisors. Please go ahead.

Rajeev Agrawal: My first question is around your gold loan book that seems to be having a very good traction, so can you compare your gold loan book to the 2 leading players of gold loan and how do you compare with them and what is your expectation there?

Nirmal Jain: It is an interesting question, but now, I will take you back a little bit to the history. So, in 2015, 2016, our gold loan book had come down, but we did not shut down many branches and we also expanded our branch network very recently, so if you compare with the 2 leading gold loan players, then still our loan, what you call principal outstanding, our branch would be lower than them. I think we will be in the range of 4 Crores, whereas the leading player maybe in the range of 7 Crores, so that just shows that there is a capacity to grow, we can also be in that similar range, capacity to grow in terms of our loan assets from this branch network if you just focus on marketing and sales and being competitive in these areas. I really do not have the numbers of 2 players, how they have done in terms of growth, also one of them is slightly more aggressive in terms of yield and their interest yield typically, I mean both of them, their yield typically tends to be higher than ours. Normally, we focus on customer relationship from a longer-term perspective, where we try to cross-sell multiple products including insurance, mutual funds and other loan products, so our approach is a little different, and maybe the customer segment also maybe a little different because our focus maybe on more, even with the gold loan product on SME kind of clients where we expect cash flow to basically take care of the loan and therefore, if you really look at the number, I do not know whether that number will be transparently available all over or not, what is the auction to our loan book, so where we have something like less than 0.1%, so if you take loan of 3 to 4 months, then typically we will not auction more than 0.3% or 0.4% of actual loans that we disbursed.

Rajeev Agrawal: But do you expect your gold loan book to continue to have traction or this was one-off, can you just talk about how you see the gold loan for yourself?

Nirmal Jain: I think gold loan will have traction because as I said, that our branches are still, in terms of their capacity, they are not fully utilized. Our loan cost per branch is still low, and therefore, our opex is high, so we can make sure that these branches go to the optimum level, not only that, we will also probably set up few more branches, so I think gold loan traction we will continue to see for maybe next year also.

Rajeev Agrawal: Got it. Now coming to how you are funding yourself, I noticed that your assignment is now almost 31% after sources of the fact, right, so clearly, you are funding yourself significantly through assignment and securitization, where you are preferring assignment, can you just talk through the economic of a assignment versus a securitization and would you continue to be much more preferring assignment over securitization, just give us some sense of the economics of the 2 modes of funding?

Nirmal Jain: So maybe, Sumit will explain it to you in terms of what our approach and what our strategy.

Sumit Bali: So overall, if you see now assignment has taken over and now our borrowing on commercial paper is virtually nil. Going forward, I think assignment will be in this range and probably slightly lower. The advantage of assignment is, this is a true sale, so you transfer the risk also and it goes off your balance sheet, so it is a more capital-efficient way of running the business, having said that, at this level is where we would want it to be, and we would want more assets here after on book and that is our strategy going forward with easy liquidity, I think, we are set for a better Q4.

Rajeev Agrawal: So how much capital do you have to set aside for when you are assigning versus securitization?

Sumit Bali: No, assignment is true sale, so you do not have to put aside any capital.

Rajeev Agrawal: You will have to either over collateralize or have some cash?

Nirmal Jain: It basically gets adjusted in the commercial, so typically, you have securitization is slightly lower rate. In assignment, the rate will be slightly higher because the risk of loss is also getting transferred to buyer of the assets. So typically, the way it happens is that CRISIL or some rating agency will make an estimate of the losses of the portfolio and they would do it with the history of the business as well as portfolio and they say that, okay, 0.6% is the expected loss of this portfolio through the entire life cycle of the portfolio, so if there are securitization happening at X price, then it can happen at X plus something. Alternatively, securitization will happen at the same rate, but then they will ask you for a cash collateral, so maybe typically say 5% of cash collateral you keep with them. On which, what happens is that, there can be bank fixed deposits, so you have a negative carry on that and your book is running down, so even if your book has run up to almost 0 level, the cash collateral remains stuck with the bank, so that is how securitization happens and therefore, from our point of view, assignment is a clean true sale where the risk is assessed upfront, you are not blocking any cash collateral and basically, it is going off the book completely. In case of securitization, the amount of cash collateral will get knocked down from your capital, practically speaking what will happen, if the banks that are buying the assets, if they are more comfortable with you, they have done business with you for a longer term, they will take assignment, it will be easier for them to take assignment, and the company's loan on their books. If you are a new player, they have not done business with you, then they might insist on securitization. Sometimes also when you are doing business with foreign banks, they may say, no, we do not want assignments, they want PTCs, which is securitization, so these are all negotiated transactions, but more and more, I think given a choice, we will prefer assignment. Given a longer term, we have raised a lot of long-term resources, if you see our liquidity, at 3300 Crores cash on hand and almost similar amount of uncommitted lines, now we are fairly comfortable, so we really need to weigh every transaction based on cost of funds, our cost of capital and our strategic requirement, so assignment will now become stabilized at this level. They would not increase as the percentage of our total loan assets.

Rajeev Agrawal: Got it and so the cost of funds for you from assignment versus the securitization is similar, the capital investment you are doing?

Nirmal Jain: In the immediate future, but supposing you are doing a mortgage asset assignment, you do a securitization at 8%, but what you have done is 5% of cash collateral given on which you have a negative carry, so 8%, supposing you say 8.7% complete assignment, now what will happen, your yield every year, it will be less than 70 basis points, but ultimately through the tenor of the loan, you would make that up because your capital’s not getting blocked, the losses are not coming to you and things like that.

Rajeev Agrawal: Got it, fantastic and the assignment income, I think we talked about the assignment income was almost like 2%, right, of the NIM?

Nirmal Jain: Not on the NIM.

Rajeev Agrawal: Out of 8.2%, I think, 2% was assignment, was not it?

Nirmal Jain: the 8.2% is based on total loan assets, right?

Rajeev Agrawal: Yes.

Nirmal Jain: 2% of the total loan asset is our assignment income. What we will do is that immediately after this call we will upload our numbers, giving you breakup, so I think that will make things clear.

Rajeev Agrawal: Got it and Sir, I think this is pretty good because it is keeping our leverage low and it seems like it is a very good way of funding and is it fair to assume that most of the assignment is happening from the home loan book because that is where it is not easier to do the assignment?

Nirmal Jain: Actually, a lot of the assignment happened from gold loan book, you know what happens, gold loan is completely collateralized assets, so for bank, on their balance sheet, gold loan has 0% risk weightage because you got a full collateral.

Rajeev Agrawal: Got it.

Nirmal Jain: but I think it is not that it is only home loan, it is all 3 asset classes that we assigned, even microfinance is there.

Sumit Bali: So, I will just add to the reply, what has also happened that since assignment and securitization have become very prominent on our funding side in the last 15 months, and the banks also have a first-hand asset quality experience on the assets in their book, so they know that this asset is nil, for example, gold gives virtually 0 losses or home loan, they know the portfolio is good, so today, when they are willing to lend money, and there is overall liquidity in the system, given the fact that they have experienced our assets, that is how we have been able to have conversations and raise money in Q3 and going forward in Q4 also I think most of the conversation is that if you want 200 Crores assignment, you also give us about similar amount of term loan to create more assets to sell down further, so all that has been helpful in raising liability.

Rajeev Agrawal: Right. I absolutely feel that given the granularity of the book that IIFL has and your ability to assign, I think that makes you one of the few players who can easily raise funding when we need it, right, compared to the liquidity challenges many others are facing actually pretty helpful. Now coming to the provision cost, I think the previous participant also asked this, and I also wanted to ask this, in you P&L, there is a negative provision that you have been taking in the last few quarters, so if you look from Q4 2019 onwards, every quarter, you have an impairment of financial instruments, which is a negative number, which basically means that you are actually reversing the provision, is that correct and can you explain why that is?

Prabodh Agrawal: I will just explain that, and this is also in response to the earlier question from Anita of HSBC. So, there are 2 line items in the expenses, one is the net loss on derecognition of financial instruments under amortized cost category, that amount is 49.38 Crores in the latest quarter. Now that comprises of 2 items, one, there is a write-off of 70.6 Crores, and then there is the interest strip, income of 21.2 Crores, so the net amount is 49.38 Crores that is the net loss on the derecognition of financial instrument and the second is impairment on financial instruments, which is a negative number, which you are saying that is -35 in the latest quarter, that is actually release of ECL, so the way it is accounted is that when you write-off, you release the ECL, so there are 2 separate items, the ECL, which is being released, that is credit item, and the write-off happens, which is a debit item to the P&L, so this 35.8 Crores is the ECL release.

Rajeev Agrawal: Is it because your net loss due to categorization is always higher and I am not seeing the breakdown, is it always that the write-off is equal to the negative on the impairment of financial instruments, this is balancing in the last 2 quarters if I look at it?

Prabodh Agrawal: There are certain assets on which we have made 100% provision, in which case the ECL will be equal to the write-off and there will be certain assets that have made a 70% provision, so the write-off will be slightly more than the ECL release.

Rajeev Agrawal: Got it. Sorry, I am taking too much time, if you want me to come back then I am happy to do that.

Prabodh Agrawal: One question we can take.

Rajeev Agrawal: So, in the MFI loans, you have this 100% credit linked insurance coverage, can you explain what that is and how that works?

Sumit Bali: Yes, so essentially, that is the cover for the loan amount given, so every individual is covered to the extent of loan and in the unfortunate event, if the customer passes away, the loan is waived and insurance company covers that loan, that is what it is.

Rajeev Agrawal: So, this is only in the case of somebody passing away it is a sort of life insurance, got it. I have a few more questions, I will come back.

Moderator: Thank you. The next question is from the line of Savi Jain from 2Point2 Capital Advisors. Please go ahead.

Savi Jain: I have a question on your home loan business, so one is, you conduct the entire home loan business through your subsidiary, right?

Nirmal Jain: it's a wholly owned subsidiary, you are right.

Savi Jain: So in that, do you also do developer financing in that subsidiary?

Nirmal Jain: Yes, there is a construction finance, they have subsidiary also, but when you see these numbers for the developer's book, they are consolidated, they are for NBFC as well as HFC put together.

Savi Jain: So, the percentage that you are showing for your development and construction finance that includes loan given from the subsidiary as well?

Nirmal Jain: That's right. Out of that, 4700 to 1180 Crores is from asset sales, the roughly 3500 Crores is from NBFC.

Savi Jain: My second question was that your yield on the home loan segment is continuously increasing from 9.3% in FY2018, it has gone up to 11% in a declining interest rate regime, so are we onboarding subprime customers because this is also coinciding with the uptick in your NPAs and how exactly can we manage to continue to lend to salaried people at these kind of yields and obviously, because our cost of funding is increasing, so how do you see all of these dynamics playing out?

Nirmal Jain: I would not say surprised, but given the market and the liquidity squeeze everybody has increased the rate. This is a boarding yield, not the portfolio yield, but already, we are seeing that from this month onwards, the interest rates are coming down and in the last few quarters, our focus was more on very small town affordable segment and PMAY scheme in which government gives subsidy etc . Interest rates of various sub-segments have not changed much, but the relative contribution of the subsegment, which is the affordable category has gone up a little bit, but even there, as I said earlier in this call, that we have seen NHB has reduced the interest rate and we are passing that on to our customers, so when our cost of funds had gone up, we obviously passed on to the customer, and focused on certain segments that we are competitive in, but as we speak, I think things are getting normal and back to where they were.

Savi Jain: But when you have 57% of your loan book going to salaried segment, are these people better off taking loans from banks, who will also rely on their documentation to give them loans at much lower rates, so why exactly are they coming to you?

Nirmal Jain: So that 11% is weighted average, this is not what we are charging to everybody and at the same time, most of these people, today if you really look at it many of the larger players in the affordable home loan segment, I do not want to take names, there are very 2 large players, they stopped disbursing new loans and therefore, the competitive intensity in these places has gone down. These are the segments or the geographical areas, which are really not reached by large players or where your relationship with the developer etc all those things matter and this is again, the last 2 quarters where we have seen that the boarding rate has gone up in line with the market.

Savi Jain: Right, so most of these homes are like stand-alone units, right, they are not like flats of big buildings or something?

Nirmal Jain: No, mostly, they are flats or apartments in smaller towns. See, home loan is around 16 lakh to 18 lakh, so the value of the house will be around 22 lakh to 25 lakh, so there you cannot expect any big building or a banglow for that price.

Savi Jain: Right and what is the risk rate for these loans that you carry, do you carry like 50%?

Nirmal Jain: No, the risk rate, mostly it can be up to 75%, 100% also depending on what kind of loan is it, so it varies, but it is typically, small ticket loan can be 75%.

Savi Jain: Thank you.

Moderator: Thank you. The next question is from the line of Chandra Govind from Ashmore. Please go ahead.

Chandra Govind: In your opening comments, you mentioned that a substantial developer portfolio can be moved to AIF, is it moving loan portfolio to AIF or is it seeking incremental lending to the same developer from AIF, why I am asking this question, because if we are moving loan portfolio to AIF, we need to do paid value addition once again?

Nirmal Jain: So, if you look at whatever provisions we have provided for, we are not carrying loan portfolio at price more than fair value. Fair value or maybe even less then fair value the way it is carried on our books, net of provisions. Having said that, for new incremental loans, we have moved to our AIF almost 2 or 3 years back and by now, we have got almost 6 or 7 Real Estate funds. The latest fund -India Housing Fund, where we have Fairfax and DEG as core investment and sponsor, that is partly invested. So the new loans we are doing there. Now, what we are talking about is a structure that we had done with another large developer also; where we pull together all these assets, which are high-risk and high-yield and basically, there are HNI /institutional investors who are looking at slightly higher risk and one of the thing in the fund structure, you can have a senior and a junior series - series A and series B, where the cash flow timing can vary and therefore, the different risk appetite can be met there, so I am saying they are considering it, but still nothing concrete at this stage. Hopefully, once our diligence and everything is over, we will come back and we will work on this.

Chandra Govind: Got it. Thank you.

Moderator: Thank you. The next question is from the line of Shiv Kumar from Unifi Capital. Please go ahead.

Shiv Kumar: Thank you for the opportunity. Sir, we see that in the developer finance book, the G&P has come down sequentially from 4.8% to 3.8%, so what led to this improvement and can we expect the same kind of trajectory going forward in terms of asset quality improvement?

Nirmal Jain: I am just connecting Balaji, who heads our real estate, one second.

Balaji Raghavan: So as you recall, I think the last time around also when we had this conversation, so there are certain series of lumpy exposures, so sometimes what happens is that some of these transactions tend to sometimes go over the quarter and some of them then gets pulled back, so this is one such instance, otherwise, the book is doing fine, so sometimes, we do have these aberrations of 1 or 2 transactions going up and down, so that is about it.

Shiv Kumar: So, can we expect this 3.8% to also trend down going forward in the next quarters, do you have any visibility of any improvement in the asset quality that way?

Balaji Raghavan: Yes, I think in the next 2 to 3 quarters, you will see improvement

Shiv Kumar: Right, in Q2, you had made a mention that the developer finance book itself would be run down to the extent of 40% over the next 6 to 12 months, do you still stand by that commitment?

Balaji Raghavan: I think, a little over 12 months, so I think whatever we said last time around also, is that about a year or so down the line, we will see run down, so that is happening, so I think we should see that.

Shiv Kumar: Right and coming to the microfinance book, we see that there is this slight spike in the GNPAs from 1% to 1.3%, can you explain what is the exposure to this troubled areas Assam and some districts in Karnataka and how is it looking like currently in terms of asset quality?

Sumit Bali: So, the increase, as you rightly observed is due to the agitation in Assam. Assam only accounts for about 2.4% of our overall portfolio, but the increase in GNPA largely comes out of Assam, so we are not doing more business there. Again, the MFIN is also engaged with the finance ministry and the local government, and we hope to see things settle down there. I think, post couple of natural calamities in Odisha, specially, we have seen now things settled down and come on course, so by and large, we are in reasonable control of the situation.

Shiv Kumar: And what about the Karnataka exposure?

Sumit Bali: Karnataka, again, the problem specifically is only in the Mangalore region, again that is close to about 3.5% of our AUM, but that also as we speak, I think there is a fair bit of engagement with the local bureaucracy, who is very keen to ensure that the whole thing settles down, so we do not have large exposure in these areas, but we are in control of the situation.

Shiv Kumar: Sir, for the business loan segment, we see that there is hardly any growth over there with the intake, the GNPA at 4%, so what is the strategy going forward, is this a course correction kind of thing wherein you want to not grow the particular segment, while you look to amend the asset quality issues over there?

Sumit Bali: So this is a segment where I think as broadly as an industry, especially on the secured LAP product, the risk return has gone haywire, so it does not make sense from our perspective to be doing large ticket LAP deals wherein the rates are very low, so we have course corrected and brought down our average ticket size down to about 20 lakh and we do both secured LAP and unsecured business loan, so that combined, I think, now there is a degrowth in the portfolio, but I think more or less, it is settled down now, so it will be steady for some time before it starts growing, but we have identified the segments, which we want to be in, which is the low ticket LAP and the unsecured business loan, those will be our growth drivers in this segment.

Shiv Kumar: And currently, what will be the proportion between the LAP and unsecured business loans?

Sumit Bali: About 65% is secured LAP and 35% is unsecured business.

Shiv Kumar: And what is the ticket sizes in each of them?

Sumit Bali: So, LAP also incrementally is now down to about 23 lakh, 24 lakh, and the business loan is down to about 16 lakh, 17 lakh.

Shiv Kumar: Right. Sir, one last question on the capital market segment, we were under the impression that incrementally that segment has moved to IIFL Wealth and we would hardly see any loans being done here, so is there a rethink in the strategy, and we can actually see capital market loans as an emerging segment at IIFL Finance?

Sumit Bali: No, so it still remains one of the synergistic segment, which is not the growth segment for us, even when you talk of growth, overall, still it is less than even 1.5% of AUM and that is I think it is likely to remain between 1% to 2%. These are largely to our retail IIFL Securities customer, that is what we will do, but as I said, this will remain in this region of about 2% of AUM.

Shiv Kumar: Thank you, that is it from my side.

Moderator: Thank you. We will move on to the question that is from the line of Kunal Pawaskar from Indgrowth Capital. Please go ahead.

Kunal Pawaskar: The other question was that the number that is there on Slide 15 of 38 of the PDF, which is the 2% assignment came that is put in the NIM chart on the top right, that number has basically kept on growing over the last 3 reporting periods in FY2018, FY2019 and 9-month FY2020, what might that be due to, the nature of this?

Nirmal Jain: The total assigned assets are increasing. We make about 5% margin on the assignments, which works out to 2% of total loan when you are looking at these numbers, so actually, when we look at NIM traditional way, that is what this explanation is, but otherwise, you have to look at these numbers separately, so there is a 6.2% NIM on the balance sheet assets and then there is about 5% margin on securitized assets and obviously, this income is growing in tandem with the total quantum of securitized and assigned assets that we have.

Kunal Pawaskar: So, to be clear, please correct me if I am wrong, but is it fair to look at it this way that for us to tag the 2 numbers together in one stack chart?

Nirmal Jain: See what happens that you define NIM in a particular way, where you see what is the interest income and interest expenditure difference and that you divide by loan assets on your balance sheet, so you get this number 8.2, but if you ask me, analytically, this number does not make much sense because what is happening in this NIM, the interest income, we are getting net credit for assigned assets, so supposing our assigned asset is 10% and my yield is 15%, then the 5% is getting into the gross income without any corresponding interest cost for that, so we separate these numbers, but when we separate these numbers, now we are taking the 5% income on assignment as a percentage of loan assets on balance sheet, so the diagram actually doesn't not make sense, the only thing is it explains that if you calculate the NIM based on the balance sheet numbers, how would it look like, so where is this 2% extra coming from, but what I am saying is that, as I said, today itself, we will put the breakup of these numbers, which will make it very clear.

Kunal Pawaskar: Got it.

Nirmal Jain: So there's interest income on balance sheet assets, there is an interest cost of balance sheet assets, so thats net interest income now add income of securitized assets, and then you get the total NIM as reported in the profit and loss account. We also had to make adjustments for the CV business because in the loan AUM, the CV business is not there for the last year and this year, but last year, the interest income and interest cost will have the CV business interest income and cost, so when you look at these numbers normalize, you will be able to make sense of the ratios.

Kunal Pawaskar: And one very last question, this is a bit more on accounting that when this income is booked on assignment, any assignment transaction happens, per the result filed with the BSC, this strictly does it show an interest income head?

Nirmal Jain: Yes, the spread on the assignment assets comes in interest income as per Ind-As.

Kunal Pawaskar: And is there any amortization or is it taken as a one shot transaction?

Nirmal Jain: Yes, it is interest income over the period of the asset.

Kunal Pawaskar: Originally, whatever that asset was, 5 years gets amortized over 5 years' time, fine.

Nirmal Jain: The income gets accrued over 5 years.

Kunal Pawaskar: Got it. Thank you.

Moderator: Thank you. The next question is from the line of Nikhil from Sundaram Mutual. Please go ahead.

Nikhil: Thanks for taking my question. Sir, in the press release, point number third, you mentioned that during the quarter, IIFL subsidiary has transferred its microfinance portfolio to Samasta Microfinance for a lump sum consideration of around 172 Crores, so why was this done?

Nirmal Jain: So, you know what happened when we acquired this company, this company had a very small balance sheet and they were still getting established, but now it is known as IIFL subsidiary, and business is very established. So earlier, they were originating assets when they were not properly capitalized and the assets were on NBFC balance sheet, so they were acting as agent or a co-origination model where microfinance assets were sitting on the NBFC balance sheet because the MFI company did not have adequate capital. But now that it is capitalized and fully on its own, so the microfinance assets, we have transferred it back to the MFI.

Nikhil: In NCR, I believe, I think, for our real estate book, we would be having around 25% of the exposure in NCR, I just wanted to check with you, whether do we have any exposure in these accounts, radio, supertech, on-net, IDO, which I think one of our other HFC has classified these as check accounts, so just wanted to check whether do we have any exposure in these?

Nirmal Jain: We cannot disclose the names of the borrower, but whenever if the asset has any problem, then we have already provided for and we have taken it as NPA, but I really cannot disclose the names of the borrowers on a granular basis or what is the exposure actually, but as I say that if any of the specification is there they are provided for.

Nikhil: So out of our 4600, 4700 of RE book, we do not see any further assets slipping into NPA in the next 6, 7 months?

Nirmal Jain: So, based on the current state, whatever we can estimate or expect, we have provided for it. We do not expect further slippages in this.

Nikhil: Fine, Sir. That is it from my side.

Moderator: Thank you. The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Just 2, 3 questions. One was on the home loan side, your book has been almost flat for last 3, 4 quarters, so is it something where you just kind of slowed down disbursements because the offtake is low because the rates are higher or is it something that the repayments have gone up because of balance transfers?

Nirmal Jain: No, actually, the boarding yield has been, as somebody has just pointed out, so we are basically pricing it based on cost of funds, but yes, offtake was probably lower/ disbursals were slower, probably because of the rates we have, one and two, many places we were very cautious because even if the builder is getting stuck and we are financing the approved project, then even with the home loans it might get in difficulty, but having said that, as I said, these things are easing now, eg NHB – a principal refinancing organization, they have reduced the interest rate and they also realized that if the keep rates higher then many housing finance companies may not be competitive and disburse so that has happened. But we are seeing good positive traction from December, the month was significantly better than earlier sort of 8 months and I think that will continue in this quarter also.

Nischint Chawathe: And how many cities you operate from?

Nirmal Jain: So, I think we operate from 600 cities, but home loan probably is not in all the cities, but it will be in a good number of cities, maybe at least 200 to 250 cities.

Nischint Chawathe: Because if you look at 200, 250 cities, it is obviously, a fairly large footprint that you have?

Nirmal Jain: But see this footprint has recently expanded , a significant part of business still, so we are expanding, we are training people, and they will start contributing meaningfully in one year's time.

Nischint Chawathe: Your size of the book is not that large that if you are operating in like 200 cities, you know kind of struggle on growth of good quality developers across, I mean, you are already large, it is not that you are in select geographies?

Nirmal Jain: No, I think, if you get a look at the affordable segment, we are next only to Gruh finance in terms of size, so at 15,000 Crores book, when the average ticket size is around 15 lakh, the size is fairly good, as I said that from many of these cities, as we are expanding our footprint and we get to scale in a year's time, so that is what will drive growth as we expand our geographic footprint.

Nischint Chawathe: No, what I am trying to say is that growth may not or quality of projects or stress may not be so much of an issue, given the fact that your size is small, and you already have a wide footprint that is what I was trying to say?

Nirmal Jain: Yes, that is right and we have been cautious in the last few months, but I think we are seeing that the environment is changing a little bit for better and also the segment that we are operating in, there are some other housing finance companies, and a couple of them, at least, have stopped business, so there also is an advantage in terms of making sure that we keep the credit threshold high and still grow the business.

Nischint Chawathe: Sure. On the MFI side, when you say that your ticket size is 20000 is it like ticket size per loan or is it average loan per borrower?

Nirmal Jain: Ticket size per loan, but in MFI, you do not have too many multiple loans for borrowers because these are most of our loans are in the JLG model

Nischint Chawathe: There are MFIs who have multiple loans for borrowers from various needs, so I was just wondering whether?

Nirmal Jain: No, I think, we have not done that. So what happens is, there are MFI regulations, so anyone cannot have more than 2 or 3 loans from all the lenders, not only from us alone, so if somebody has already got, say 2, 3 loans from other microfinance companies, then they are not qualified for a loan from us, forget about multiple loans from our side.

Nischint Chawathe: Sure. On the tax rate side, what really happened this quarter?

Nirmal Jain: So, this quarter is normal tax rate. Last quarter was slightly lower because the first quarter, we have provided for tax at a higher rate. So this quarter is 22%, which is applicable tax rate.

Nischint Chawathe: 22%, you are getting any rebate in specific products because I think the corporate tax rate would be higher, right?

Nirmal Jain: No, I think this is the revised tax rate. So on some of the liquid asset, if we are getting dividend that is tax free and kind of things…

Nischint Chawathe: And just one final question, Prabodh was clarifying with this particular quantum in write-offs and I think you mentioned that 70 Crores of write-offs and 20 Crores of interest rates, so I was just trying to understand what that interest rate was?

Prabodh Agrawal: Nischint, the 21 Crores is the interest strip on the assigned assets

Nischint Chawathe: And that is also something, but why will you write that off?

Prabodh Agrawal: No, that is not a write-off that is just an offset, so there is a 70 Crores of write-off, and there is 21 Crores of …

Nischint Chawathe: 21 Crores of income that you have drawn on assigned assets.

Prabodh Agrawal: So, the net amount is 49 Crores, which has been debited.

Nischint Chawathe: And this is the ongoing one, right, this is on sale?

Prabodh Agrawal: No, every quarter, we book some gain because this quarter, we get to about 2300 Crores assignments, so every quarter, whatever is sort of new volume we will book as interest strip on that and old also, there will be some amortization, so the net amount this quarter was 21 Crores.

Nischint Chawathe: Got it, great. Thank you very much.

Moderator: Thank you. We will move on to the next question that is from the line of Rajeev Agrawal from DoorDarshi Advisors. Please go ahead.

Rajeev Agrawal: Thanks for giving me the opportunity again. So, I just wanted to understand on the DCF portfolio, I think it was asked that your quality is improving, but there has been a lot of concern around the overall real estate, the sales, what are you seeing on your side, are you seeing that the traction is picking up now or if can you just talk about the broader real estate market that you are seeing?

Nirmal Jain: Well, you are saying that the real estate market is improving or not that is what the question is?

Rajeev Agrawal: Yes. How are you seeing the real estate market?

Nirmal Jain: I think the projects, there is a demand and it is not that the demand has become 0, but demand is for affordable houses because now the demand is more from end users instead of investors. The demand is where location is good, and people think that project will get executed, and they will get their apartment or house, so actually again, Pune, Hyderabad, Bengaluru, these markets are doing well. Bombay suburban good location, they have seen good traction and not only the project funded by us, but otherwise, also. The problem areas are, obviously, the very high priced pocket of Central Mumbai or certain areas of Gurgaon, and maybe certain areas of Noida, so I think the problems are more concentrated there, but if you look at Central Bombay, it has absorbed large amount of system credit and therefore, people are concerned about the whole system and as I said that the improvement and traction we have seen is more in the affordable segment, so if you look at Bombay, up to 1.5 to 2 Crores is affordable, if you look at Bengaluru, it will be 50 lakhs, so of you look at Delhi, it may 50 lakhs to 75 lakh, depending on which area you are in and other cities, maybe 30 lakh, 40 lakh, so every city has a different market.

Rajeev Agrawal: Got it and what percentage of our loans would be still under moratorium?

Nirmal Jain: Moratorium, you are saying the developer loan?

Rajeev Agrawal: Yes.

Nirmal Jain: So, I think there are at different stages, so not too many loans will be under moratorium. There is no interest moratorium, the principle moratorium is fairly spread out, so there are different stages.

Rajeev Agrawal: Got it and then on the business loan side, I think we had in the previous quarters indicated that the GMP went up because it was a seasonal issue, right, I think in Q1, Q2, you talked about seasonality, possibly causing the GNPA to go up from 2.2% to 3.8% and then 4%, into Q3, we are still seeing it as 4%, so are we expecting this to go down or what is the expectation around the business book?

Sumit Bali: So typically, what happens in this is that some of these cases will be treated legal during the course of the year, it takes about 4 to 6 months to bring the customer to the situation where either we get to sell the property or if we makes it online or balance transfer the loan, so we expect improvement this quarter, also do understand that there is given the slowness in the economy overall, there have been headwinds in this sector, so that also has meant that we kind of slowed down our growth there, and we have remodeled our business to look at pricing the risk appropriately, so you will see an increase in the boarding rate, which is largely to take care of the risk in this segment and so our strategy continues to be that the price we choose the that the price it appropriately and do follow-on with strong collections, so that is how we will be.

Rajeev Agrawal: So, should we expect higher yields, and therefore, and also higher credit costs going forward in this particular business?

Sumit Bali: No, that is not the idea, so we have increased the yield, but I think the GNPAs will remain at this level where they are or probably come down in this quarter. It depends a lot on in terms of resolution getting the case order from the arbitrator, etc.

Rajeev Agrawal: Got it and this is one segment, which was primarily cash flow based, and then you were using secured LAP, as you have mentioned, which is now at 65% for more than 50 lakh, so clearly, you have brought down the ticket size here from what we understand, right, where you were getting the collateral in terms of the property and so do you expect the secure LAP portion to continue to grow from 65% to even higher numbers, are you looking at more than the cash flow as a basis for giving the loan?

Sumit Bali: So, cash flow assessment is necessary for every credit approval because eventually, collateral is just a deterrent, so our policy is that anything above 50 lakhs must have a collateral. Though, there are cases below 50 lakh also where we do take collateral, so cash flow assessment is necessary. Collateral, as I said, above 50 lakh must, below that is also certainly a segment of business, which we do and we have priced it appropriately, and we have reduced the ticket sales and this is the way forward for this business.

Rajeev Agrawal: All right and then my last question is on the home loan, I think this question came up earlier as well, which is we have a boarding deal of 11%, cost of funds is 9.5, but if you were to just look at our home segment and accounting for NHP finance and everything, what would you say is the cost of fund in this particular business?

Nirmal Jain: Cost of funds, around 9% or so, but incrementally, it is coming down. You know what happens iNHB refinance there are different rates for different pools of assets, so when we are doing a very small ticket home loan then they give you loan for refinancing that at a lower rate, so home loan business is segmented and you have to apply different cost of funds for different segments.

Rajeev Agrawal: Right and Sir, what would we be shooting in terms of a return on equity for a business like the home finance, is it similar to the rest of the business, or this will be a lower return on capital business?

Nirmal Jain: No, I think given our ability to securitize and sell assets as well as earn cross-sell income of it, if you look at our balance for last year and maybe this year as well, it generates similar areas with return on equity, so our target would be to, as we have said earlier, to take the return on equity 20% range, which is around 17% today, applies to both businesses. So home loan can be 18% to 20%, return on equity very comfortably and if you are able to continue the securitization and assignments over a period of time this can improve from there also.

Rajeev Agrawal: Got it, great. Thanks a lot.

Moderator: Thank you. The next question is from the line of Shiv Kumar from Unifi Capital. Please go ahead.

Shiv Kumar: Thanks for the follow up opportunity. Sir, what is the incremental cost of borrowing in Q3 and what is the blended cost of borrowing?

Prabodh Agrawal: So, my total cost of borrowing is 9.45 and my incremental cost of borrowing will be close to 9.25.

Shiv Kumar: So, with such a higher cost of borrowings, do you still think that you would be able to grow the home loan category at these rates?

Nirmal Jain: So, this is the 9.45, what we are saying is the weighted average or aggregate cost of borrowing. In home loans, as I said, we are getting refinancing at a lower rate and so therefore, we have to look at it from that perspective and I think the rates have been brought down the last quarter by some of the refinance organizations and we are very comfortable and confident that we can grow this business from next quarter onward pretty well.

Shiv Kumar: Sir, in Q2, you are expecting a new refinance line from NABARD, has it come?

Sumit Bali: We have raised 150 Crores in our MFI from NABARD that came through this Q3

Shiv Kumar: Sir, one question with regards to developer finance, have you seen any of your clients get support from the real estate fund, which was launched by the government?

Nirmal Jain: Not yet.

Shiv Kumar: Are there any proposals wherein you are trying to access those funds for some of your stressed accounts?

Balaji Raghavan: So, we have submitted a few proposals to them as to start with to see the process and the mechanism that they are suggesting. We have been interacting with the team also, so we will know probably sometime in the course of this quarter as to the outcome of that.

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

Nirmal Jain: Thank you so much, everybody and if there are any more queries or clarification required, please be in touch with our Investor Relations. Thank you. Have a good day ahead.

Moderator: Thank you. Ladies and gentlemen, on behalf of IIFL Finance Limited, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.