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2nd November 2023

To,
BSE Limited (Scrip Code: 532720)
Phiroze Jeejeebhoy Towers,
Dalal Street, Fort,
Mumbai - 400 001

National Stock Exchange of India Ltd. (Symbol: M&MFIN)
Exchange Plaza, 5th Floor, Plot No. C/1, "G" Block,
Bandra - Kuria Complex, Bandra (East),
Mumbai - 400 051

Dear Sir/Madam,

Sub: Transcript of Q2 FY2024 Earnings Conference Call held on Friday, 27th October 2023

Further to our letters dated 23rd October 2023, 27th October 2023 and 28th October 2023, and in compliance with Regulation 30, Schedule III, Part A, Para A (15)(b)(ii) and other applicable provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"), please find enclosed herewith the transcript of Q2 FY2024 Earnings Conference Call held on Friday, 27th October 2023 at 6.00 p.m. (IST) and concluded at 7.00 p.m. (IST).

The transcript of the Earnings Conference Call can also be accessed on the following link:
https://www.mahindrafinance.com/wp-content/uploads/2023/11/Transcript-Earnings-Call-Q2F24-002.pdf

This intimation is also being uploaded on the Company's website at:
https://www.mahindrafinance.com/investor-relations/financial-information#transcript-of-earnings-call

Please note that no unpublished price sensitive information was shared/discussed in the aforesaid Earnings Conference Call.

Kindly take the same on record.

Thanking you,
For **Mahindra & Mahindra Financial Services Limited**

Brijbala Mohanlal Batwal
Digitally signed by Brijbala Mohanlal Batwal
Date: 2023.11.02 19:03:18 +05'30'

Brijbala Batwal
Company Secretary

FCS No.: 5220

"Mahindra & Mahindra Financial Services Limited

Q2 FY '24 Earnings Conference Call"

October 27, 2023

MANAGEMENT:

MR. RAMESH IYER: VICE-CHAIRMAN & MANAGING DIRECTOR

MR. RAUL REBELLO: EXECUTIVE DIRECTOR, MD & CEO – DESIGNATE

MR. VIVEK KARVE: CHIEF FINANCIAL OFFICER

MR. DINESH PRAJAPATI: HEAD - ACCOUNTS, TREASURY, & CORPORATE AFFAIRS

MODERATOR:

MR. ANUJ SINGLA: BANK OF AMERICA SECURITIES

Moderator: Good evening, ladies and gentlemen. Please note, this call is not for media representatives or Bank of America investment bankers or commercial bankers, including corporate and commercial FX. All such individuals are instructed to disconnect now. A replay will be available for Bank of America investment bankers and commercial bankers, including corporate and commercial FX. The replay is not available to the media.

Good day, and welcome to the Mahindra & Mahindra Financial Services Limited Q2 FY '24 Earnings Conference Call. This call will be recorded, and the recording will be made public by the company pursuant to its regulatory obligations. Certain personal information, such as your name and organization may be asked during the call. If you do not wish to be disclosed, please immediately discontinue this call.

As a reminder, all participants lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing star then zero on your touch tone phone. Please note that the conference is being recorded.

I now hand the call over to Mr. Anuj Singla, please go ahead.

Anuj Singla: Thank you, Dorwin. Good evening, everyone. This is Anuj Singla from Bank of America Securities. Thank you very much for joining us for the Mahindra Finance call to discuss quarter 2 FY '24 earnings. To discuss our earnings, I'm pleased to welcome Mr. Ramesh Iyer, Vice Chairman and Managing Director; Mr. Raul Rebello, Executive Director and MD and CEO-Designate; Mr. Vivek Karve, CFO; and Mr. Dinesh Prajapati, Head, Accounts, Treasury and Corporate Affairs. Thank you very much for the opportunity to host you, sir.

I now invite Mr. Iyer for his opening remarks. With that, over to you, Mr. Iyer.

Ramesh Iyer: Thank you, and welcome to the call. Good evening, everyone. The way I would like to kind of begin with is to start from what we see on the ground as the reality and then how do we see our own numbers for this quarter, and how do we see it going forward. So I think -- and I would -- when I'm speaking of on ground, I will also try and bring in the color of the festivities that we have already seen that has gone by.

I think overall, I think the sentiments remain positive. When we talk to dealers across the country, they seem to be happy with what's happening out there, while the inventory levels were starting to build, but I think the footfall at the dealerships continue to remain robust. And therefore, the retail volumes are doing well.

And in light of the festival season, which just went by and when we talk to the OEMs, they are very excited with what they have been able to accomplish during this festival season and they are preparing themselves for the next big festival Diwali. And they are very confident and hopeful that the inventory levels would get corrected as well as the retail would be substantially good and better.

I think on the overall front, I think monsoon finally ended positive, though with some hiccups in August, and some kind of a delay happening in September. But on an overall basis, ending up at 94% average is a good number to look at, and the sentiment seems to be driving positive there. The infra front, again, is seeing good traction. We are seeing deployment of assets doing well. Labour absorption is pretty good. And most of the states are on overdrive when it comes to infrastructure, when it comes to mining. So therefore, even on the infra front, things seems to be doing pretty well.

From our perspective, these are excellent trends to look at. These are the cash flows, which really drive this business, both when it comes to disbursement as well as when it comes to the overall collection and collection efficiency leading to asset quality.

In spite of the fact that the monsoon vertically were extreme sometime in July, went dry in August, went -- again picked up in September, it's important to note that the number of days available to operate during this period normally goes low and slow on -- because of the climatic condition. And which is why historically, the rural market has always reflected lower disbursements, lower collections, asset quality deterioration in the first two quarters of the year, and that's been our trend in the past.

I think what has happened during these two quarters and the quarter gone by the first one and now the second quarter of this year is we have really changed the trend for ourselves, and we have seen overall improvement in all fronts.

We are very happy to report that we had a good disbursement growth and the numbers are already with you. We have had a good asset growth happening. And also very importantly, our Stage 3 was curtailed at the quarter 1 level and which is lower than the March closing level. And the Stage 2 continues to show a declining trend, which again, is an excellent trend leading to believe that the forward flow is getting arrested and asset quality overall is improving.

I think what you will see in spite of the stabilizing Stage 3, there has been a higher charge, which has come into the P&L., which is kind of temporarily pressurized the profits for the quarter. And that comes from the fact that in few markets, because of the delayed monsoon situation, there was the postponement of cash flows that were happening. And they are relevant markets for us. And until 15th September, we did see things going well and then were waiting for what is the next from a monsoon news got a little delayed, but we would think that there is absolutely temporary in nature. And that's why you would see collection efficiency still ended up at 96 plus percent, the GS-3 ended up at 4.3% type level, and this temporary increase in the tractor portfolio, which went up by about INR300-odd crores for us has caused a little additional provision that we had to make.

But that's not bothering us at all. And therefore, you will also see a statement from us, which is we expect our credit loss as we close the year, is expected to come down to 1.5%, 1.7%-type numbers from where we are today at about 2.3% or so. And therefore, we don't have a hesitation to make that commitment of where we think we will end up the credit cost to be because for a very simple reason, that if the GS-3 numbers are at 4.3%, and the Stage 2 numbers are at sub-6 level, we don't expect this going down through repossession, settlements, terminations and bad debts.

This will go down further from year by pure collection. And therefore, our expectation that the credit cost would end up at 1.5%, 1.7% going forward. So far as the growth is concerned, I think we continue to remain robust to believe that the asset growth will continue to remain upward of 20% as we close the year. And the disbursements will keep in pace with for us to achieve that kind of asset growth.

And again, where are we coming from? I think the inventory levels that have been pulled up during this period for festivity has seen Dussehra to be one of the good retail numbers, and Diwali is expected to be equally good and supported with that kind of a festival output the last quarter would pick it up for further retails to happen.

So, we are confident that as we close the year, the asset growth of 20% plus will also be maintained. All of this leads to the commitment that we made for the March 25 where we would end up, we are not relooking at those numbers at all, and we are confident that we will hit those numbers.

And as far as the opex is concerned, it does remain at the levels that we were. And as we have been explaining also in the past, they are more caused by certain transformation agenda that we are driving, and they will be very natural to incur those costs to get benefits of this cost coming through in future with various actions that we are putting into place.

You would have seen certain pressure on the NIMs level that we have seen. I think 2 or 3 things I would like to call out very clearly. One, I think we expected that the borrowing cost would come down, and we have made that statement that our expectation was around the festival and post festival, the borrowing cost would come down, but I think that's getting challenged, and we don't now believe that, that cost is going to come down. While believing it will come down, we had not pushed up our rates.

But now that we are more clearer about hearing out statements from RBI, etcetera, that the rates are not likely to come down, we have already planned to increase our lending rates selectively on some models, some geographies, some products, etcetera. And that would help relook at our NIMs by March.

The other thing is, we have consciously got into certain high-quality customer segment. And while they may depress the NIMs to an extent, I think they clearly contribute to a lower opex and definitely a lower credit cost. And you will see the benefit of it as this portfolio builds further. But even in the current scenario, we clearly see the benefit of this portfolio come through.

I think the third is also an element of mix. I think the growth that would have come through in this couple of quarters is largely coming from car -- that is cars, personal segment of M&M as well as some commercial vehicles, which are, by nature, expected to be a low-yield product. But as we see the tractor pick up over the next 6 months to an extent that it could and the pre-owned vehicle that is refinanced business pick up, you will also see some correction to the yield that will happen.

Putting all these 3 together, that is our rate correction that we had talked of as well as the product mix change that we are talking of and the increased rates that we are talking of, if we were to take all these 3 things together, we believe that the currently 6.6% NIMs could inch up to a 6.8% kind of a number going by March and then our aim to take it to 7% in the following year continues to remain.

So I think 2 or 3 things that one should look at different from where we are in terms of our current research is the NIMs are expected to slightly move up, one; two, we do expect that the credit cost to settle down between 1.5% and 1.7% as we reach March and we expect, therefore, the GS-3 to improve from where it is to reach that kind of a situation.

And summarily, we always expect that the second half for rural is the best from a cash flow perspective. And this year, given also that the elections in various states, etcetera, etcetera, we believe the rural support and on-ground activity at rural will support our thinking of why and how we think that it can lead to all of this and with an asset growth of 20%, I think overall, we feel that we have had a good quarter to start with leading into the next two quarters, led by good positivity on the ground and as well as the good festival sentiments that we have witnessed.

So I think -- overall, I would say that we have a very positive outlook from here as to how do we think and project for the next two quarters. I think I would stop there and invite questions from all of you.

Moderator: Thank you very much. The first question is from the line of Mahrukh Adajania from Nuvama. Please go ahead.

Mahrukh Adajania: Sir in your total AUM, what would be the dealer advances because I guess that would be interest free, right? Or they would not earn interest. So in the second quarter...

Ramesh Iyer: So it will be close to about INR 5,000 crores is what we would have given us trade advance for the festivity and you must link it to the retail improvement that you're seeing, which will get converted in this quarter.

Mahrukh Adajania: Okay. But this INR5,000 crores is higher than the festive season last year. I know the quarters are not comparable? Or is this...

Ramesh Iyer: See I think the advantage is, when the festivals come in 2 different months, the volumes normally are even much higher because they need to stock for 2-month requirement, right? And if it is both at the same month, it's a very different game. And last year, if you see when availability was an issue as to why will they make so much of advance really available.

Normally, it is about INR3,000 crores, INR3,500 crores. This time, it's INR5000 crores, because we also we've also grown in our market share and more products are getting added. So, I think you need to add all of that. And correlate to our disbursement growth and correlate to our AUM growth.

Mahrukh Adajania: Got it, sir. And sir, so the lending hikes, the lending rate hike that you are talking about, they'll actually show their impact on NII in the fourth quarter, right? Or will we see it in the third quarter as well because borrowing costs, as you said, are sticky?

Ramesh Iyer: Yes. So therefore, what would typically happen is whatever increase that we will announce this month, let's say, some trickling will happen between November and December. But you're right, the larger benefit would then be seen from the fourth quarter, which is why I said, as we come to March end, you would see the NIMs improve, going up to 6.8% plus kind of a number.

Mahrukh Adajania: Got it. And sorry, just to clarify, just one last thing from me. You said that there was an additional provision of INR3 billion made on the tractor portfolio. That's correct?

Ramesh Iyer: No, no, no, not on tractor alone. I'm saying that's -- not provision. It's a INR250 crores of NPA increase, which is -- I mean, GS-3 would have increased. It is not -- it is -- from Q1. It is not only tractor. I'm saying largely driven by tractors. But from a provision perspective, it will not be more than kind of INR100 crores. So if you look at our GS-3 number, June was INR 3,770 crores and it has ended up as INR 4,024. That was the INR250 crores, INR300 crores that I was talking of. The provision arising out of that will be about INR 120 crores, INR 130 crores type numbers.

Mahrukh Adajania: Got it. Because your ECL cover has gone up again, though it was very strong, right? Stage 3.

Ramesh Iyer: So clearly, these are temporary things as the provision gets reversed in the next quarter, you will see this come back to the 60% type.

Mahrukh Adajania: Okay. You mean the tractor or the NPLs related to this quarter, that way.

Ramesh Iyer: Exactly. Because these are very, very temporary because overall asset quality and overall on-ground reality is that we don't see any deterioration. This is very temporary between 15th and 30th September, some delay in few markets, which would then react to maybe in the 15th of October, end of October kind of story.

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

Nischint Chawathe: Two years back, we sort of guided for doubling of loan book by FY '25 end and probably tracking well on that. But I think on the profitability front, we are below the guidance of around 2.5% ROAs. So would you probably say that from now on, the focus kind of shifts towards profitability and which is probably the reason why you are guiding for sort of 20% loan growth versus 27%, what you're doing right now?

Ramesh Iyer: So Nischint, if you kind of really look at it, the NIMs that you see a little compression, as I was explaining, I think by increasing the rates that we are talking of, to some extent, will address that. And the product mix change that we were expecting for a better yield which is more of a preowned vehicle growth, while the demand holds up availability of preowned vehicle continues to remain a little challenge.

And therefore, we are seeing a little compression of growth in the pre-owned vehicle segment, but we do expect that with the exchange program during festival, etcetera that should help improvement of the NIMs coming from that direction as well.

What we have missed out is we thought at least a 25, 30 bps benefit we will get from the borrowing cost side from where we were. I think that's something which is getting a little challenging at this stage, but maybe next year, if that comes through, then that's an additional benefit. But at this stage, I don't think we are relooking at our return numbers any different from what we had committed because if we do achieve this end credit cost of 1.5%, 1.7% that we are talking about for this year-end, you would see a substantial change to the profitability as well.

And last -- first quarter was a good quarter from even profitability angle. In this quarter, there is a dip of at least INR100-odd crores, which is coming due to a temporary additional provision that we are carrying on the little increase in GS-3 that we saw, that would get reversed in the third, fourth quarter kind of a situation.

So I'm not too worried about is there going to be a relook at return level. And that's not the reason of the 20%, 25% growth that we are talking of AUM. I think we are continue to take a cautious look at the growth for a simple reason that if the interest rate remains elevated, will we start seeing some drag in the marketplace from a demand perspective is something that we are seeing, but we are not re-lighting our market share position. I think we are holding on to market share. So if the volumes on the ground remains robust, our growth could be even better than what we are projecting for ourselves.

Nischint Chawathe: So somewhere, you're probably saying that, look, the overall demand might come down if you end up some of the other players kind of raise lending rates because I think your overall...

Ramesh Iyer: I think we should realign sometime in December after the Diwali offtake is completed because that will give a very clear -- because Dussehra was phenomenally positive. And therefore, the sentiments remain positive at all dealership. And if Diwali continues to go that direction, then probably our confidence to say that we are even willing to look at 25% asset growth is something that we will rediscuss.

Moderator: The next question is from the line of Viral Shah from IIFL Securities. Please go ahead.

Viral Shah: I had a few questions. So number one, was on your credit cost guidance of up to 1.7% is this what you're talking for the exit quarter or for the full year you are talking of, for this year?

Ramesh Iyer: We're talking for the full year. So if we are today at 2.3%, let's say, as we close March, you would see that number look like a 1.5% to 1.7%.

Viral Shah: Fair enough. Secondly, I wanted to understand more from, say, a medium-term perspective, you are retaining your 2.5% ROA guidance. Can you walk us through how it can -- how you can reach the bridge over there over the medium term? Because even if you say, take 7% kind of your gross spread, and then what is the kind of opex levels that you're looking at and then the credit cost? And how are we arriving at 2.5% ROAs?

Ramesh Iyer: Yes. So if you kind of look at 7% as the spread or NIMs and then 2.5% that takes us to 4.5%. And if we were to look at a credit cost of 1.5%, 1.7% that will lead us to that position of anywhere around 3 minus the tax will lead you to that 2.5%, 2.25%, whatever that number we are talking of.

Viral Shah: Fair enough. And you are retaining the growth guidance of roughly around 23%, 24% CAGR, right? Because that is what would be implied by the doubling of asset book.

Ramesh Iyer: That's right. That's right. See, so far, we have not seen the price increase meaningfully from OEMs. So I'm reasonably sure next year, if they were to push up the prices of the vehicle, even the same volume will give us some additional disbursement.

Viral Shah: Fair enough. And sir, if I come to your Slide 9, over there, on the one hand, we are saying that we are targeting the relatively better quality of customers/the product segments. But if I look at your SME disbursements or even the others which are there, over there on a Y-o-Y basis, there is actually a decline. Why would that be?

Ramesh Iyer: No. So in the past, we have had something called institutional lending, which was in the book. And if you recall about a year back or so, we said we are going slow on that because of the market conditions, we believe that, that segment may have a differential behavior, and we were not in a hurry to kind of jump into SME growth through that.

And therefore, you will see that book runoff. And the new book that we are building is all around our SME lending with LAP included. And therefore, honestly speaking, they are not comparable in nature. But if you were to remove the institutional part from our earlier book and then look at the SME comparison that we have a healthy growth.

Viral Shah: Can you, sir, help us quantify the quantum of that institutional book historically so that we can have like-for-like comparison...

Ramesh Iyer: I will ask Vishal to get in touch with you. But if my number is right, we may have about INR1,000 crores of institutional book left from some INR2,000-odd crores or something that we had earlier, INR2,300 crores or something. But don't capture this number. This is more indicative, but Vishal will give you exact numbers.

Viral Shah: Sure, sir.

Moderator: The next question is from the line of Piran Engineer with CLSA. Please go ahead.

Piran Engineer: Just firstly, on NIM improvement, what gives us the confidence of improvement? Is it simply a loan mix change? And just related to this, what percentage of our loan book will still be at a higher yield, which will be refinanced downwards?

Ramesh Iyer: So as I was explaining, the NIMs improvement will come from 2, 3 things. One is we are pushing up the rate for some of the product, some of the geographies selectively. So that will by itself push it up. Second is the currently that customers also asked, the book includes a trade advance of about INR5,000 crores, which is nonearning, let's say. And as they convert to retail, that will also start bringing in the earnings, right, automatically.

And the third is the product mix change, where we believe that preowned vehicle is not going to perennially be non-available situation. And therefore, you will start seeing improvement or increase in growth of preowned vehicle, which comes at a better yield. So I think it's a mix of many things, it's not any one thing.

And we are not talking of a very substantial, what we call NIM improvement. We are saying we are at 6.6%. Will this just go to a 6.8% plus number. I think the answer is clearly yes. And then the following year is where the attempt to take it to 7% will come. By then, the borrowing costs will start contributing also another 15, 20 basis points.

Piran Engineer: Okay. But sir, my only thing is maybe say you're giving a car loan at 12% and now you start getting it at 12.5%. But if the car loan that is maturing from the book, is at 14%, it is still a negative interest rate sort of hit, right? So my question essentially came from that point of view.

Ramesh Iyer: No, I think the way we are seeing it. I think the past book is more or less kind of gone now. If you look at it last 2 years, I don't think our rates were like before. So we are already used to this rate of 12%, 13%, 11% and all of that. So you should consider that even if the past book is running off, they are not 14%, 15% lending rate items.

Piran Engineer: Got it. Got it. Okay. And sir, secondly, just in terms of disbursement growth, while near term, of course, festive demand is strong, we've not really expanded our branch count in quite a few years. So just from a sustainability point of view on the disbursement growth or AUM growth, what would be your driver beyond, let's say, just price hikes?

Ramesh Iyer: So let me just quickly tell you, branch -- branches are not for disbursement, right? They are servicing units. So they are closer to customers to ensure servicing. The disbursement units are the ones that we interact with OEMs and with dealers. And they can be dealt with, even if a branch is a little away from where we want to be.

But that does not stop us from opening more branches. But for sure, you will see in the next 6 months, branches also getting open. It's not that we are not going to. As you know, we have undertaken a transformation agenda, and that is causing us to relook at the way we want to structure our branches and the way we want to position our branches, and that's the reason we were a little slow on that. We are fairly on that job. But I can assure you that disbursement growth will not be hampered by branch not being open.

Piran Engineer: Okay. Okay. And just last question. Last year, our credit costs were 1.2%, 1.3%. And we've improved the loan mix towards better quality customers. Overall, the macro environment, I would say, still as favorable. But we still have a credit cost guidance, which is 40, 50 bps higher. So, I just wanted to understand the disconnect here.

Vivek Karve: So there is no disconnect, Piran, Vivek here. So, a large part of that 1.2% was also facilitated by a significant write-back that happened last year. So if you look at Slide 24, you will find it that in both Stage 2 as well as Stage 3 between the two, almost INR 1,300 crores provision write-back happened. And that is also because from the beginning position to the end position, there was a significant reduction in both Stage 2 as well as Stage 3.

But if you look at current year, we started the current year with a Stage 2 of in and around 6%, Stage 3 in and around 4.5%. From there, although some correction will happen and some improvement will happen, the expected write-backs on account of lower provisioning on the back of further reduction in these 2 is expected to be lower. So then what is left in the credit cost is largely the credit losses.

Now if you look at the credit losses and look at the full year number last year, which was almost INR2,200 crores. And if you look at H1 last year, which was INR1,100 crores, look at the current half, it is almost half of what we had to incur in H1 last year. So that's the trajectory we believe is more sustainable. And that's why we are guiding to a number which is in the range of 1.5% to 1.7%. So to an extent, 1.2% last year and the guidance of 1.5% to 1.7% this year are not strictly comparable.

Piran Engineer: Okay. So then I take that as a sustainable guidance if the environment remains as good, would be 1.5% to 1.7%. In other words, we will never go back to 1.2%?

Ramesh Iyer: No, we would because as you start seeing the new book that we are currently underwriting, you touched on that, when they start building up and some of our past portfolio starts maturing, right, you would start seeing -- that's the reason you have seen the GS-3 number and GS-2 number, both declining, right? So if you have a GS-2 which shows continuous decline, the future GS-3 will be lower than where we are today.

And that automatically will lead to a much lower credit cost. What Vivek explained to you is a comparison between last year to this year, why and what happens. But if your overall GS-2 is coming down, which automatically means the GS-3 of future will be even lower than where we are.

Vivek Karve: And further to that, Piran, even the credit losses, as the asset quality improves, credit losses, which we have experienced to be lower compared to last year. We can expect those losses to even go finer as we go into future year.

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

Kaitav Shah: I have 2 questions. Number one was on the capital usage. It seems to be a bit sharp. So is it just related to the lower profitability or something else as well?

Vivek Karve: Is your question about capital adequacy, Kaitav?

Kaitav Shah: That's right, sir.

Vivek Karve: Yes. So I think, as you know, the profits in the second quarter are a little lower. So, to that extent, the accretion to the profit will be lower. And second is after the AGM, in the second quarter, dividend payout happened. So, to that extent, net worth has gone down. So as the profits build up in Q3 and Q4, the capital adequacy will once again improve.

Dinesh Prajapati: And the asset also. Growth is accelerated because of festival season.

Vivek Karve: And the asset growth, especially at the end of Q2 to a question that was asked on the trade advance level. So to that extent also -- yes, the capital has got utilized, which is normalized in Q3.

Kaitav Shah: Sir, the second question was around the provisioning. So while you've already given your guidance that for full year, you're going to be in a certain range. But if we look at the trajectory, it means like a sharp reduction from Q2 levels, first half levels. So what sort of modeling are you building in? If you can just describe more in detail because the dichotomy between the higher provisioning and improving asset quality still remains a bit puzzling for us?

Vivek Karve: Yes. So it's not that complicated, actually. So what we believe is that the reducing trend on credit losses that we have experienced in H1, we will remain in that trajectory during H2. And there will be a recovery led reduction in the Stage 3, which will primarily lead to a 1.5% to 1.7% credit cost. Probably beyond this, I may not be able to explain.

Kaitav Shah: And is that kind of already visible in the first month of this quarter, I mean, on a trend basis?

Vivek Karve: Here, we are talking about prognosis for the second half. So I would not like to get to a very micro level discussion only for the first month of the third quarter. I hope you understand.

Ramesh Iyer: But just keep one thing in mind that always historically, even previous year, the second half is always the best half for us because most of the cash flows in this market start to happen now, right. After the monsoon, then you'll have the harvest, the money coming in, the infra contracting segment payment starts getting released, they get closed by March when the government closure happens. So I think there's a lot of cash flow, tourism is during this period. So be rest assured that the cash flow of this market is also disproportionate compared to the first half.

Moderator: We have the next question from the line of Abhijit Tibrewal from Motilal Oswal Financial Services. Please go ahead.

Abhijit Tibrewal: Yes. So just wanted to understand on the credit cost side enough and more has been discussed already. But if I just look at the write-off number broadly around INR 310 crores last quarter; INR 350 crores, this quarter. When can we expect this number to kind of start tapering off, given that we talk about a very healthy Stage 2 and Stage 3. Do you think run rate in write-off will sustain here? Or is there a reason to believe, given that Mr. Iyer also talked about the fact that there could be potentially a time where we could even get to 1.2% credit costs once the new book that we're building becomes a respectable proportion of the book. When can we expect these write-offs to kind of start tapering off?

And then so a related question is that, I mean, by the asset quality per se has improved, why is it that you're not seeing the provisioning coverage ratio kind of come down because I think the provisioning coverage ratio should be more a function of the underlying asset quality rather than per se, the slippages that we see during the quarter.

Ramesh Iyer: Yes, you're right. But if you recall in our provisioning, on our contract where it hits an 18 months, we actually make an 80% provision. And once the overall GS-3 number comes to, let's say, a 3% type level over a period, I think all this will get revisited. See all this was introduced when we had a higher GS-3 and we wanted to be prudent in taking higher coverage, right? And we have got it done from 7% to 6% now to 4%.

And as I was just explaining, we do believe that it has an ability to go down to 3%, 3.5% over a period of time. As that happens, then many of the questions that you are raising will go away because then settlements don't happen through repossessions and therefore, the losses will come up from there. It will be purely a function of recovery and settlement that is beginning to happen, right? And same will be true on that day when you therefore look at our LGD, that will also get corrected once it's a 42 months kind of a history that we look at. As you start seeing the past book as they run off and each time a new year is added. And as you see in the last 2, 3 years, when they really come into active in the 42 months you, will start seeing this begin to happen automatically. So the way you should look at it is that if the fundamentals are corrected and are being held at certain level, then the aggravated correction will happen as the book starts to run off from the past.

Raul Rebello: And Abhijit, to your first point on tapering off of write-off. If you look at Slide #24, FY '22 was INR2,513 crores, last year was INR2,213 crores, last year, first half was INR1,114 crores. We are already 40% below that at INR664 crores. So this number will not be 0 ever. This is a business wherein there will be losses on settlement and losses on bad debt that move out. But the way in which we are originating today with the kind of composition mix of our origination with every month as we see the overall NTC and subprime come down, this number is directionally already tapering down and our guidance and our expectations will further go down.

Abhijit Tibrewal: Got it. Sir, and just one last question. I mean first one is a follow-up to what you've answered that in your internal estimates, I mean I don't want you to put out a number to it. But I mean, how soon can this ECL by EAD, which is 4% right now, start tapering down towards 3.5%. That's the first question. And the last question for Mr. Vivek Karve.

Sir, while we are for NIM expansion of 6.6% to 6.8% by the end of the year, just wanted to understand, given the fact that -- I mean something...

Moderator: We have the next question from the line of Raghav Garg from AMBIT Capital. Please go ahead.

Raghav Garg: Just one question, sir, which you had pointed out that you would maintain your guidance of 2.5% ROA for this year. Is that understanding correct?

Ramesh Iyer: Sorry, I think that the question that was asked to us was March 25, our target is 2.5%. Are we relooking at that? The answer is no, we are not really looking at it. We are confident that we will reach that 2.5%. It is not for this year. The question that was posted to us was March '25 that we are looking at 2.5%, is it still -- are we holding to it? The answer is yes.

Raghav Garg: Understood. Did I understand it correctly that you may revisit your growth guidance for FY '24 post Diwali because I think earlier, you had mentioned a number of 20%. I'm sorry, I may not have understood it well. Could you explain again if that's the case?

Ramesh Iyer: Again, the question that was asked to us is, if your disbursements are doing well, why are you talking of just 20% to 25% AUM growth. Further, the answer was that with the interest rates remaining elevated, we have to also see how the -- Dussehra was extremely good, we'll see how the Diwali retails happen. And then we'll relook at what the OEM's projections are and if required, to relook at the number, we'll redo it for the fourth quarter.

Raghav Garg: Understood. Sir, my next question is on capital. So you've almost reached about 16.5%. And it's quite probable that the profit growth will remain lower than what your AUM growth aspirations are. Back in FY '21 when you gave to the market for capital raise, your Tier 1 was around the same level 15.5%, I think. Do you anticipate raising capital in the next 1.5, 2 years?

Vivek Karve: For the next full year, definitely not because we believe the capital adequacy continues to be quite comfortable. The circumstances under which the last capital raise was done was in the -- right in the middle of the COVID period. So I think they are not 2 comparable periods. It also is a function of growth. But as we see, at least for the next 1, 1.5 years, the fresh capital raise looks unlikely.

Raghav Garg: What would be the minimum Tier 1 that you're comfortable with?

Vivek Karve: So right now, we are at 16%, 16.5%, right? So profit will also get added and will aid the capital adequacy. I think we are in that ballpark even today. The regulatory is 10 plus 5. So we are right now 16.7% plus 2%. So the headroom is quite significant today. So between 12% to 13%, you can say.

Ramesh Iyer: 13%.

Vivek Karve: Yes, 13%.

Moderator: The next question is from the line of Ashwini Agarwal from Edelweiss Mutual Funds. Please go ahead.

Ashwini Agarwal: Sir, we had guided earlier that there has been a change in strategy, and there will be less seasonality in our books going forward because whatever changes you have done in the last 1 year. But if we see, if we go by the numbers, things have more or less remained the same. And I have been tracking the company for the last maybe 15 years, last 7, 8 years or a decade, we have been like not able to read the markets properly in terms of demand or in terms of cost of funds. So how do we read that? Because, just a few months back, we had talked about a decent growth and then the availability of used vehicle is less.

Moderator: Sir, sorry to interrupt, but we are losing your audio in between.

Ashwini Agarwal: Sir, I've been tracking the company for the last 15 years, for the last 7, 8 years or so, I think we have not been able to read the business correctly. Just a few months back, we had talked about that there has been a change in the strategy and the business is to be less seasonal. And there was a strong demand for used vehicles.

But how did we not read that the availability of used vehicles is not there? Maybe just 3 months ago, the tone was different. So was there any difficulty in reading the demand scenario, availability of vehicles or cost of fund? Because even in terms of cost of funds, this spike was not expected by the management, right?

Vivek Karve: I think you have multiple questions in 1 question. So let us first take the preowned vehicles. So if you look at, I would draw your attention to Slide #9. So if you look at the pre-owned vehicles, the Y-o-Y growth in Q2 in disbursement is 20%. And in the first half, it is 26%. So both these numbers are ahead of the total disbursement growth that we have posted. So 20% versus 13% for the full company and 26% versus 20% for the full company. So I don't think we are deviating from the strategy. We have to focus a lot more on preowned vehicles because

Raul Rebello: You can take that comment which Mr. Iyer made and our internal targets were much higher. We wanted to have a higher growth that's trending, and we are still in a leadership position in the market.

Vivek Karve: Yes. So that was your first question, right? And the second question was about the borrowing cost. So we agree that, we felt that the borrowing costs will start easing out. But you're also witness to what's happening in the global markets, the kind of hardening that the U.S. markets have seen. And in a global, we are a global citizen and therefore cannot remain insulated from what happens in the U.S.

And the firming up of the rates in the U.S. has had its implications on the Indian market also. And that's where the interest hardening has happened. Further, if you look at the guidance is given by both Fed as well as the Reserve Bank of India "higher for longer" is what we hear. And this is something which has been talked a lot more during the Q2 as compared to in the previous quarters. So our prognosis changes based on what we experienced and what we've witnessed in the marketplace.

Ashwini Agarwal: Sir, if we go by your word that higher for longer, in that case, our cost of funds will go higher. And we won't be able to pass on the rates after beyond at some point. So do we expect some kind of a deacceleration in the growth numbers which you are expecting going forward in the second half of next year?

Ramesh Iyer: So let me kind of state it more clearly, if the borrowing cost goes up for everybody, I'm reasonably sure that everyone will push up the lending rates. I don't think we have any doubts, right? So I don't think the growth has to be recalibrated only for us just because the borrowing cost is going up and our lending rates will go.

Everybody will push up the lending rates. Will that lead to overall demand falling in the market? I think that's for the OEMs to look at whether they will offer discounts like they did in the past, will they offer some programs and maintain their demand. I think those things, we will have to take it as it happens. As we stand today, we don't see a pressure of rates -- ability to pass on rate. It's our judgment call that we made a couple of months back to say, okay, let's not push up the rates, pre-festival as post festival, the rates come down, then we will not have to do.

And we are correcting ourselves to say, no, we don't see that rates are going to come down. And we are not saying tomorrow morning, the rates are going to go up. It may go up in 3 months' time, 6 months' time, but we are not going to wait for 6 months to increase our rate. We are already doing it. So I think these kind of judgment calls will be made. Sometimes it may go right, it may go wrong. But I think it's not appropriate to conclude that we will not have the ability to pass on the borrowing cost.

Yes, that ability will not be there if we are the only ones who are going to suffer from that. But if the cost is going to go up for everybody beyond the point, people are not going to just absorb it, today, most of the players are absorbing it. I think reasonably, I'm sure post Diwali, you will start seeing everybody increase the rate.

Moderator: The next question is from the line of Sanket from DAM Capital. Please go ahead.

Sanket: So I have 2 questions. One is on the margins, where we say, we will maintain all the thresholds for FY '25. Well, on AUM and opex, we might be able to achieve it, but we have modified the margin guidance. So we are saying 7%, right, for next year. That's about 50 bps lower. So if at all, you maintain 2.5% ROA, then the improvement needs to be there on the credit cost side. Is that correct? And is that the place where in confidence is coming from the credit cost will make up for the margin loss?

Ramesh Iyer: Yes, absolutely correct. I mean if you look at our GS-3 and GS-2 numbers, they are improving, and they are better than what we originally set out for ourselves, right?

So we said we will be 6%, we are saying that is already at 4%. So it will go even below that is what we are seeing. So that would translate automatically to a lower credit cost leading to a better ROA. While we may not cover it through the NIM, but it will be more than covered through the credit cost.

Sanket: Okay. So the follow-on question on that is, sir. So our target is to keep it below 6%, we are already at 4.3%. And if we add up, say, Stage 2 as well, the 30 dpd plus is around 10%, which is better than what we used to have pre-COVID. Then why since last 2 quarters, we have been hard pressed to keep the Stage 3 at the same level and rather take the hit on P&L if it's, we are so certain of write-backs in second half, maybe some inch-up in Stage 3 would have been in business as usual as we have seen in previous years, Y-o-Y, yes.

Ramesh Iyer: So I think one of them asked this question. if you look at, we are carrying on an 18-plus contract, we are carrying a much higher coverage of 80%, that's what pushes this up. As we see the past book fully getting corrected and all the new book comes where we don't see too many contracts beyond 12 months, etcetera, etcetera, we will revisit all these numbers.

I mean, maybe another 3 months, another 6 months, we will start relooking at this and bring it down to a coverage level, which is most appropriate because if you have a GS-3 numbers hovering around 3%, 3.5%, then maintaining just a 40% cover or a 45% cover could also be adequate.

But that will be all driven by formula because it's a 42-month historic data, which gets captured to arrive at this number. And up to COVID period, as you all know that we had a higher write-offs and things like that, as those years cross by and as we start more kicking into '21 as the base year '21, '22, '23, '24, you will see this naturally get corrected also.

Sanket: So as you are moving deeper into the normalized macro if you were not to hit any disruption, the LGD base requirement of the formula that ECL flow that could come down what you suggest and basically which the credit cost would be below normalized?

Ramesh Iyer: Yes, that is clearly reflective of our Stage 1 and Stage 2 today, right?

Moderator: Ladies and gentlemen, we have two more questions in queue. The first comes from the line of Kunal Shah from Citigroup.

Kunal Shah: So sorry, so again, with respect to Stage 2 and Stage 3 currently, at say 10-odd percent. Now given that we are aware in terms of the profile, which is getting built, more towards the lower-yielding asset pool, where do we actually see this settling, in this kind of an environment? Because I think that's what is something which will drive the credit cost down to 1.5%, 1.7% because I think write-offs will still continue to be at similar levels of maybe INR300 crores to INR350 odd crores per quarter, yes.

Ramesh Iyer: It's about 4.3% and 6% around, therefore, the 10%. We believe that with changing portfolio, etcetera, the GS-3 could be somewhere around 3%, 3.5%. And therefore, the Stage 2 could be somewhere between 5% and 5.2% or whatever. So 8% - 8.5% should be definitely achievable as we progress.

Kunal Shah: So that is still possible. So we could see that similar kind of run rate which we see in the second half, given that we have already got it down or we have contained it in the first half, it's not necessary that getting it down from here on will be difficult.

Ramesh Iyer: But don't take it for this quarter, next quarter. I think we are moving towards our March '25 commitment. I think you will see that happen during the course of that quarter.

Kunal Shah: Sure. And secondly, with respect to opex to assets because there is going to be another lever to manage the ROAs at 2.5%. So last quarter also, you highlighted we'll see the inch up and post that, we will see the moderation getting into 2.4%. But maybe it's still stabilizing at 2.8-odd percent level. So should we start seeing the leverage play through earlier than what we anticipated? Or still there are investments which will be done over the next 2 quarters?

Ramesh Iyer: So Vivek will take you through, but it will take some time. We are still in the midst of our transformation agenda, investments in technology, investment in data. All of that is happening. We see, while it sits in opex, I very strongly see it as an investment towards a better portfolio of future. But anyway, Vivek will kind of take you through more details.

Vivek Karve: So Kunal, we are not expecting a sudden moderation. So the 2.8 levels that you are seeing for the first half are likely to continue for the balance of the year at least. They may inch up a little as you know, our investments are getting accelerated. But as Mr. Iyer rightly said, these are investments, and these are not expenditures. Therefore, they will start paying off over the next couple of years. So the benefit will not be necessarily seen in the current quarter and maybe even the next year, but you will certainly start seeing that benefit starting FY '25-26.

Kunal Shah: Okay. Got it. So maybe that 2.5% for FY '25, you are saying maybe that would also not -- maybe that also still the investments will be on?

Vivek Karve: Kunal, when you created this mission by the end -- at the beginning of April '22, this is an aspiration that we have. And we would make every attempt to meet it. Some parameters, we will exceed, some parameters we may lag. So this whole attempt is to be there at the end to deliver 2.5%.

Ramesh Iyer: I think ROA is the target that we are holding on to strongly.

Moderator: Ladies and gentlemen, we will now take the last question from the line of Abhijit Tibrewal: from Motilal Oswal Financial Services.

Abhijit Tibrewal: Sir, what I was kind of trying to understand at that point in time and I think partly answer the last 2 questions, is that when I look at the PCR and not just the Stage 3 provision cover, I'm even referring to your Stage 1 and Stage 2 provision cover, given your visibility into the customer mix, given your visibility into your ECL model, which considers the last 42 months data, I think what you were trying to suggest to some of the previous participants is that in the next 3 to 6 months is where we should start the provision covered even on Stage 1 and Stage 2 to start coming down. Was that the right understanding?

Vivek Karve: No. Abhijit, that's not the right understanding. As you rightly pointed out, Stage 1 and 2 is both a function of PD and LGD. So our analysis and our numbers suggest that it will take at least another 9 months before the LGD cover starts improving because the LGD has been impacted because of the COVID period. So it will stabilize only in the latter part of next year. But on PD, because of the much healthy reduction in the early delinquencies, the PDs have been sequentially improving for us.

Abhijit Tibrewal: Got it, sir. Sir, one last question for you. Given that we've already guided for NIM to expand from 6.6% as on H1 to 6.8% by March '24. I just wanted to understand, I mean, cost of borrowings I mean, over the next 2 quarters, how are they likely to trend given your visibility on your liability mix and based on what is kind of coming up for renewal, maturity? And when can we reasonably expect the cost of borrowings to start plateauing?

Vivek Karve: You are asking me a question, which I'm not qualified to answer, very frankly. But I think the reset costs every time the borrowings were getting replaced with new borrowings, that impact was felt largely in the first half. So going forward, the impact of the reset is likely to be much lower as the liability character keeps changing. However, we still believe that it is not likely that the borrowing costs will start sliding quite immediately.

Our attempt will be to always maximize the PSL route, and therefore, try and borrow at finer rates given the benefit that we have on the acquisition side. So I'm sorry, but very difficult to predict or provide you a prognosis as to when the borrowing costs will start sliding down. We hope they'll start doing it earlier, but beyond that, I don't think I'm qualified.

Ramesh Iyer: Your earlier speaker said we are already proved wrong once. So don't push.

Abhijit Tibrewal: Sir, but there you also said that it is about maybe a judgment calls that we take, right? And it's okay to go right, go wrong at times after all you are running a business.

Ramesh Iyer: At this stage, with what we are reading, hearing, understanding, it looks unlikely that it's going to come down in the next 3 months, 6 months' time. This financial year is not visible at all to bring down. Maybe it's after that.

Vivek Karve: Unless you are hearing some other commentary, happy to understand that better.

Moderator: Thank you. I would now like to hand the conference over to Mr. Anuj Singla for closing comments. Over to you, sir.

Anuj Singla: Thank you, Dorwin. Mr. Iyer, any closing remarks before we conclude?

Ramesh Iyer: So I think hearing all the questions, I thought it may be useful to just rephrase and resummarize the whole thing, which is we are confident that our asset growth would be in the ballpark, upward of 20% plus. And maybe post festival, we'll feel happy to relook at that. Clearly, with the kind of collection efficiency we see and the kind of levels of GS-3 that we are in and the level of Stage 2 that we are in, we are pretty confident that as we close March, we should not be beyond 1.7%, that is 1.5% to 1.7% as a credit cost.

We will make every item to see what can be saved on the opex, but we strongly think that it's a conscious spend that we are doing as an investment to make sure that we build a stronger base for the growth trajectory that we are looking at. And we continue to remain very buoyant in terms of growth opportunity in the market that we are representing. And the NIMs pressure that we are currently witnessing from the numbers that you see have 2 or 3 conscious calls, which is one that we are getting into a mix of customers, which will be more stable, for sure, going forward.

Two, a product mix change with better availability of pre-owned vehicle will help us improve yield, increasing the lending rates in certain products, certain geography, certain segments will also help us improve the margins. And then, of course, whenever the borrowing cost comes down, we'll further improve the margin.

So overall, we remain committed to the ROA returns that we had committed for '25 and the balance sheet growth that we had committed there. And for an immediate basis, closing March, I think we are confident to restate that 1.5%, 1.7% as a credit cost with an asset growth of up about 20% is the visibility that we have. And thank you, everyone, for taking this call.

Vivek Karve: And Anuj, I also take this opportunity to wish everyone on the call a lot of festivities during the Diwali festival.

Ramesh Iyer: Happy Diwali...

Vivek Karve: Happy Diwali to all of you.

Ramesh Iyer: And watching the World Cup Finals with India playing on one side. .

Anuj Singla: Thank you, sir. Back to you, Dorwin.

Moderator: Thank you. We now conclude this conference. Thank you all for joining us. You may disconnect your lines.