IIFL Holdings Limited

Consolidated Financial Results – Q3FY18

Conference Call Transcript

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Management

Mr. Nirmal Jain – Chairman, IIFL Holdings Limited

Mr. R. Venkataraman – Managing Director, IIFL Holdings Limited

Mr. Prabodh Agrawal – Chief Financial Officer, IIFL Holdings Limited

Mr. Karan Bhagat – Managing Director, IIFL Wealth Management Limited

Moderator: Ladies and Gentlemen, Good Day and Welcome to the IIFL Holdings Limited earnings conference call for Q3 FY '18. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. In case you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to the management. Thank you, and over to you.

Prabodh Agarwal: Good Afternoon everyone, on behalf of team IIFL, I thank all of you for joining us on this call. I am Prabodh Agarwal, Group CFO, accompanied by Nirmal Jain, our Group Chairman; R. Venkataraman, Managing Director; and Karan Bhagat, Managing Director of IIFL Wealth Management. I now pass the mike to our chairman to comment on the proposed re-organization of IIFL Group Company and overview of the group's strategy and plan.

Nirmal Jain: Thank you Prabodh, usually I start with some comments on the macro-environment, I'll just take a couple of minutes on that and maybe leave some more time for the re-organization discussion which I think everybody would be keen to know about.

Today there was a bloodbath in the market and people tend to get clouded by the things happening on that day or in a very short term, but broadly, to me at least, things look pretty good – macro GDP growth is estimated to be 8%. In the budget, there is a very large increase in allocation for agriculture, infrastructure, and rural sector, but I think what people are worried about is the LTCG tax. To my mind it is relatively a smaller issue, in fact just because of 10% tax on Long-Term Capital Gains, it is very difficult not to allocate assets to equity because there are hardly any other alternatives. But primarily there are a couple of things more that have happened around the budget; one is the liquidity and the interest rate, we have seen G-Sec yesterday shot up to 7.8 from the bottom of 6.6, it is quite a huge meltdown or maybe increase in the yields whichever way we look at it; U.S. Treasury also has gone up to 2.8, so world over we are seeing that debt instruments are coming back in favour; but this is a phase that will pass through. When we look at things from a medium to long-term perspective, they look pretty good. If you look at three to five years, the financial services sector, which again is a proxy play or a liberal play on the economy, is well placed.

In the journey of IIFL, I think it is a very momentous occasion when we took the big decision to reorganize our business and get three companies listed. In terms of our background over the last 23 years, we expanded into multiple financial services and now we have emerged as one of the leading financial services players in the country, but all our financial services' activities can be grouped in three distinct business lines. One, loans and mortgages, let us call it finance or IIFL Finance; two, Wealth and Asset Management which we can brand as IIFL Wealth, and the third is Capital Market activities or IIFL Securities which comprises retail broking, institutional equities, investment banking, and also commodities and currencies broking, distribution of life insurance products, mutual funds and bonds -primarily to retail and mass affluent customers. I will speak briefly about the business rational and then how we look at it from the ownership and control point of view and from all the stakeholders' point of view.

In terms of business rationale, all three businesses have clearly distinct set of customers. In IIFL Wealth, they cater to High-net-worth individuals' investment requirements; even their financing requirements are now fulfilled through a subsidiary of Wealth which is a new NBFC we started about two years ago. The Wealth vertical which is the Wealth and Asset Management company and their NBFC subsidiaries, can cater to all the requirements of HNI customers or ultra-HNI customers. Then we come to the two other businesses, IIFL Finance and IIFL Securities, they cater to retail customers. Finance is for those who want to borrow i.e. their savings are less than their requirements; and Securities is for investment advisory or investment execution for a set of customers who are saving more and typically are unlikely to be large borrowers, I mean they may have some products like home loans, but they will not really borrow the high-cost loans.

When we look at these businesses, the culture and the critical success factors are very different, if I have to describe in one or two words that what do we need to succeed or what is the key mantra for each of the business, that is as follows: for IIFL Wealth it is customer intimacy, so we can have more number of manpower available per customer or per family, making sure that the relationship and whatever the customer needs is catered to very quickly, so customer intimacy is something which is very, very important for success in the wealth business. When we come to, IIFL Finance, then it is operational excellence because we cater to retail lending; the process excellence is very important - how do we keep our credit processes, which work more like a factory because when you have millions of customers you really cannot take an individual call, and how do we keep our operating cost under control when we originate loans or do credit processing, underwriting, and collections; so operational excellence becomes a mantra for our IIFL Finance. When we come to IIFL Securities, it is the product that drives the business, so if you look at our retail business, more than 70% of the business has been through the trader terminal online, and when we look at our institutional business or the upper end of the retail client base, then they are driven by research, so it is a product innovation or a product superiority which drives our IIFL Securities business.

Also in terms of flexibility and compliance, the businesses are regulated by different regulators, so whenever we have to take a decision, if they are a conglomerate, then they have to pass through the compliance of all three departments or all the regulators and also many a times all our licenses or renewals need approval and NOC from all the regulators; say, we apply for something to RBI, they will send it to SEBI also for NOC and so on. For a long time, the business was not of size, we had to grow under one roof, but now, we believe that all three businesses have got the critical mass and have come of age to be independent. More importantly, our businesses are driven by people and the key to success in our business is the quality of people that we can attract, and our philosophy always has been shared ownership and owner mindset of the people who are with us.

Also, all the businesses require different kinds of talent and different kinds of experience; it makes sense for each business to attract the best talent and retain them, motivate and incentivize them by the stock options of the business that they are accountable for and they have control on. It gives us flexibility to enlarge the ESOP and at the same time there are much stronger efforts to reward relationships at the top management level or at the leadership level for all the businesses. Also our customers, culture, offices, branding are fairly distinct. Not only that, when we have to have a Board for all three companies, we can attract people with relevant domain expertise, who can guide the management team.

Many a times questions arise about what will happen to the cost synergies and the cost of senior management or the related party transactions. I will come to the governance in a while, but we have kept our related party transactions always at arm’s length and senior people other than the promoters also, we have different CEOs and a completely different management team for all three businesses.

In terms of cross-sell and synergies, as we have put in our press release, there is a lot more cross-sell opportunities within these three businesses rather than the intra-business, so when somebody is borrowing gold loan, maybe they become a customer for business loan or home loan also, so of course, there are some synergies across businesses, but there are lot more synergies within each of them and at the same time when we do the cross-sell or a referral, all our arrangements or agreements are at arm’s length and the referrals and cross-sell opportunities can come from outside the group also and inside the group also, they get paid based on the fair market price and practices.

Now, we look at this from the shareholders perspective, we have investors in our key subsidiaries as well as our parent company or the current listed company; Fairfax is there at the parent level, then we have General Atlantic in our wealth and CDC in our NBFC company. Our agreement with these investors actually provided us with almost about seven years to give them an exit and which was not necessarily listing of the three companies, so the demerger or the reorganization is not being done to provide an exit because I do not think that is imperative at this point in time, but from a longer-term perspective most of the financial investors have different objectives, different theme of the fund and they get attracted to different kinds of businesses, so there are many investors who are very keen to invest in asset-heavy businesses and there are many investors who are willing to pay extraordinary premium for high ROE or high growth businesses. Once the companies are listed separately, they can attract different sets of investors and that in a way make sense for all of us.

Now, almost all the businesses some of the analysts may have concerns about the size and liquidity of various businesses, and in particular IIFL Securities, which may be relatively smaller than the other two businesses, but even IIFL Securities business, if we extrapolate the first nine months profitability, then post-tax profit will be close to Rs225 crores this year, which I think will place it in say top 200 or top 300 companies in terms of profitability after full payment of tax. The point I'm trying to drive home is that the businesses are large enough. About the volatility or cyclicality of earnings of IIFL Securities, I think last two to three years a lot has changed; the securities business was volatile for two to three reasons, and why fundamental changes will make the retail side of it a little different: One is that the business is overly dependent on foreign investors and what we have seen in last one to one-and-a-half years is that there is a significant flow of domestic money and in an event like this, which we have seen in the budget, yesterday or today probably would have caused volatility of 3%, 4%, or 5%, but what we are seeing now is 1% to 1.5%, but more importantly mutual funds and systematic investment planning have emerged as a very important asset class and as we have seen with many of our investors, even in the worst of the markets we do not see any redemptions or cancellations at least from the retail investors. Apart from that in the last 20 to 23 years, we never had any occasion where any one of the business has had to be critically supported by the other businesses in terms of capital or liquidity or finance, so all the businesses have been independent and they have the ability to stand on their feet.

In terms of ownership control and synergies, or the promoter group – Venkat and I will continue to be promoters for all the three businesses and all three will carry the brand name IIFL and to that extent they are part of the same group if you look at the ultimate ownership or control. In terms of control, my own belief is that maybe in the 80s, 90s or earlier, we used to see conglomerates where intertwined ownership or a very convoluted structure will allow the promoter to control several companies through the parent company, but I think that is giving way to the new culture where small, nimble, innovative ideas driven independent enterprises do far better. More importantly all the regulators, and we have seen that in our RBI audit, encourage having a clear, differentiated structure so that the risk is also contained as well as it becomes very easy for the analysts and regulators or investors to understand the businesses and take their call on the same.

Also related party transaction will always be kept at arm's length. Whenever we see there are a lot of stringent guidelines about related party transactions that comes in the Companies Act or law, they have been introduced to primarily adjust the issues that have arisen in governance, where the populist structures have been very convoluted or complex and intertwined. We believe that these businesses that are distinct will also have lot more transparency for the outside world, public, media, analysts as well as regulators and there is a way we would like the businesses to be. Also technology and digital challenges require very quick response and if the management teams are independent our response time can improve because as I said that even the regulatory approval will become related to the business and not for the entire group.

With this, I will hand over to Prabodh and I will be happy to take questions later. Prabodh will take you through our financial numbers and the business performance in the last quarter and nine months.

Prabodh Agarwal: Thanks Nirmal.

We are very pleased to report a 36%YoY growth in our Group net profits to Rs301cr for Q3FY18. Net profits after minority interest have grown by 32%YoY to Rs236cr. Our net worth has reached Rs4,970cr. ROE was 19.4% and ROA was 2.4%. All the three segments of the company i.e. NBFC, Wealth and Capital markets contributed to this strong growth.

On the NBFC, our loan AUM grew 29% YOY and 5% QOQ to Rs. 27,288 crores. Profit after tax grew by 30% YOY to Rs. 145 crores. The NBFCs net worth is Rs. 3,848 crores, our Tier-1 CAR stands at 16.8% and total CAR at 18.2%, thus we remain well capitalized to meet our growth requirements. Our AUM growth is driven primarily by small ticket home loans, which grew by 61% YOY. The other fast-growing segment was small ticket SME loans, which grew by 98% YOY. Capital market loans declined by 31% YOY as prior period AUM included short tenure IPO funding. CV, gold, and construction finance segments are other drivers of AUM growth. In home loans, our focus remains primarily on the self-employed section which contributes to about 60% of our loan portfolio. The fastest growing segment in home loans is the affordable home segment with average ticket size of Rs 10 to 12 lakhs termed by us as Swaraj loans. Nearly, 20% of our incremental quarterly home loan disbursements are Swaraj loans. Growth in LAP book continues to be moderate as the segment is relatively less attractive due to yield compression.

Within construction and real estate finance, the mix continues to shift towards construction finance for small ticket housing project. As on December 31, 2017, we had nearly 5,500 approved housing projects up nearly twofold from 3,100 approved projects a year back. All our construction finance loans and 50% of home loans were made through these approved projects. We expect that this approach will reduce our operating and credit cost going forward for our housing finance company. We believe that the overall portfolio risk is on the decline as our portfolio mix continues to become more granular with greater share of small ticket home loans of size Rs. 10 to Rs. 12 lakhs and SME loans of similar ticket size. The increasing granularity is driving down portfolio risk while at the same time helps us derive better yields versus large ticket lending. Retail loans including consumer loans and small business finance constitute nearly 85% of our loan book. Another strong characteristic of our loan book is the large portion of loans that are compliant with RBIs priority sector lending norms, about 85% of our home loans, 60% of LAP, 90% of commercial vehicle, nearly 30% of SME, and nearly all of our MFI loans are PSL compliant. In aggregate nearly 40% of our loans are PSL compliant which we can sell down to banks at attractive rates.

The share of securitized book stands at 14% of our AUM and our aim is to take this up to 15% to 20% of AUM through higher sell downs of home loans, LAP, CV, and SME loans. This would possibly impact our profitability and CAR. Our average cost of borrowing declined by 10 basis points QOQ and 90 basis points YOY to 8.4%. Incrementally, we are now borrowing at an average cost of 8% to 8.1%. MCLRs of a few banks have risen marginally and bond yields have risen by 50 to 60 basis points over the last four months. Our endeavour is to lock in longer tenure funds at fixed rates. Our NIM was at 6.7%, decline of 47 basis points QOQ and up by 35 basis points YOY, falling borrowing cost and rising share of high yielding SME, gold, and MFI loans have helped support our NIM. On the other hand, the rising share of lower yielding retail home loans had a downward impact on the NIMs. The NIM was also lower due to one-time impact on account of premium paid on buyback of old debentures with higher yield from the secondary market. We bought back debentures of the face value of Rs. 851 crores with coupon of 9.2% to 12% and remaining tenure of four to nine months on which we paid a premium of Rs. 10.09 crores, that has hit our interest expense.

Cost-to-income ratio was at 38.1% and OPEX to average loan book ratio was at 3.23%. Many of our small ticket loan products are OPEX intensive including gold, MSME, and microfinance. As the share of these products rises, it puts an upward pressure on operating costs. Still we believe that there is significant scope for cost ratios to fall due to operating leverage and benefits of digitization.

NBFC headcount grew 19% YOY and the number of NBFC branches have grown to 1,242 compared to 998 a year back as we added branches in our HFC, gold, and MFI business. Our GNPAs were at 2.1% of loan and net NPAs were at 1.2% of loans, both stable QOQ. Sequentially, NPAs increased primarily in the real estate finance segment. NPA ratios in all other segments were flat or declined QOQ.

Some updates on digitization and analytics, we have continued our focus on digitization with more than 97% of 5.16 lakhs loan on-boarded in the last quarter on-boarded digitally. More than half of loans in December '17 were on-boarded in paperless mode using E-sign. This has increased from 37% during the last quarter.

E-KYC penetration has also been increasing across all products with more than 90% of loans booked using Aadhar-based E-KYC. With 55,000 mobile app downloads in Q3 and cumulative 2.15 lakh downloads, IIFL loan mobile app is fast becoming the channel of choice for customers for both servicing and account management. Customer acquisition digital finance vertical has tripled from 16,500 in Q2 to 56,000 in Q3 where customers have been acquired digitally and with state through paperless process.

We are continuously sharpening our cross sell efforts through analytics driven by pre-approved offers. In the last quarter, we have preapproved campaigns on our two lakh customers. This is a steadily increasing stream of new business and we will continue to scale it. We are leveraging risk analytics to screen new applications at the point of on-boarding as well as raise proactive trigger alerts on the portfolio. All small ticket SME loans are on-boarded using scorecards and the focus is to create completely automated processes for small ticket loans. Analytical triggers are also being used for fraud, auditors, and inspectors to significantly increase coverage and detection rate.

An update on the Wealth Management business, IIFL Wealth's PAT grew by 54% YOY to Rs. 100 crores. Our assets under advise management and distribution have grown 58% YOY and 9% QOQ to reach Rs. 1.28 trillion. We have excluded offshore FPI advisory assets from our total asset in this quarter given their negligible contribution to income. It shall be excluded from here on. We hired 34 RMs during the quarter, taking the total number of RMs to 317, to further drive the growth momentum. IIFL Wealth offers a broad range of product and services to participate in a larger share of the client wallet. This includes financial products distribution, advisory, brokerage, asset management, credit solutions and estate planning. We raised net new money of Rs17,991cr in 9mFY18 versus Rs15,767cr in the same period last year. During the quarter, the team garnered AUM in wide ranging products including Rs2,800cr in focussed equity AIFs and Rs200cr in focussed Debt and Equity MF products. In our AMC in India, we have raised a further Rs3,200cr in our special opportunities fund, which invests in pre-IPO and IPO situations. The total commitments in these funds is now over Rs7,300cr. AIF assets grew 30%QoQ and 63%YoY to Rs11,600cr. Total Assets under Management in our AMC are now at Rs26,165cr comprising of Rs13,494cr in our domestic AMC and Rs12,670cr in our offshore AMC. A new fund, Affordable Housing Fund was launched in this quarter, which has received good response with an initial commitment of around Rs860cr. IIFLW Finance, which offers loan against securities and margin funding to high net-worth clientele, grew its loan book 21%QoQ and100%YoY to Rs.5,847 Cr. Average lending rate for this book is around 10.3%. Net fund based income was higher in Q3 due to reversal of the one-time MTM loss of Rs15cr on investments, which had correspondingly reduced the income in last quarter. Effective tax rate for 9mFY18 was about 24% and for the whole of FY18 we expect the effective tax rate to remain in this range.

An update on the capital market, during the quarter, our average daily cash turnover was up 45%YoY to Rs1,411 Cr. Our average daily total turnover, including F&O, was up 71%YoY to Rs14,924 Cr. Our NSE market share in the cash segment remains around 4% and in total around 2%. We are continuously enhancing our offerings on digital and mobile platforms for retail customers in our broking business. Our mobile trading app, IIFL Markets has had over 1.3m downloads. Presently, about 39% of our retail broking clients trade through the mobile app. The investment banking team completed 11 transactions during the quarter, including 5 IPOs of HDFC Life, Reliance MF, Indian Energy Exchange, Future Supply Chain Solutions and Shalby Multi-Speciality Hospitals. There is a substantial pipeline of transactions in various stages of execution.

I think that ends my opening remarks and we will now open the floor for Q&A.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Pavan Ahluwalia from Laburnum Capital. Please go ahead.

Pavan Ahluwalia: My questions have to do with the wealth management side of it. Karan, we have discussed in previous calls what the best way is for us to be thinking about this business going forward and would be good to get some of your insights on how we can think about it more granularly. It seems that you basically have a team of bankers who go out and gather assets from clients and the total solution that you present to a client obviously has different margin profiles depending on what the asset is, so you are helping them allocate into a mutual fund that is managed by somebody else, there is a certain margin on that you are allocating them into an IIFL Mutual Fund, that margin is obviously higher, if you are in an AIF or more exotic products, I would imagine the margin is a highest of all, is the right way to think about this basically to assume that each banker has a certain kind of revenue generation target that some sort of multiple of their salary and they are expected to get it by achieving some sort of blended margin across the pool of assets they sell to clients and so we had to breakdown your model in operating terms, the way in which you grow is basically bringing more and more managers onto a platform because for each banker, there will be a handful of superstars who can do very large ticket, but for most bankers they will probably peak out at a certain revenue size and beyond that you need to get more people on the platform, that is my first question, and second if you look at the team you have today, how far away is the existing team from achieving peak revenue targets in other words what is the sort of operating leverage you have with the existing team and the existing cost structure versus growth that you would need to get by bringing other people on to the platform?

Karan Bhagat: Thanks. I will quickly take the first question, broadly the way we look at our business, first of all is divided into two big buckets, so wealth management business and the asset management business. Within the wealth management business, the focus is primarily on four activities. The first as you rightly said is the distribution of financial products which has today become a fairly broader term, it is not restricted only to mutual funds, it includes portfolio management schemes as well as Alternative Investments Funds, and High Net worth Individuals, whom we cater to typically, want to look beyond mutual funds, and therefore, the net market share or the net new money coming into financial products are more driven towards Alternative Investments Fund and PMS as compared to mutual funds which possibly was the trend two to three years earlier.

The second core activity is that of advice. Advice is something which is little more holistic in nature where it starts from asset allocation all the way to portfolio construction, setting up an investment portfolio, mandate and so on and so forth. The third service we provide is that of execution which is in a sense becomes the by-product of the first two because the clients would typically come to you for a financial product or for taking advise typically end up doing some bit of execution with you. Fourth is, clients who have over a longer period of time built a large amount of faith and trust and essentially start giving discretionary mandates either through a portfolio management scheme or through an Alternative Investment Fund, so these are the four segments or four levels of engagement which we have with clients.

On the asset management side, we focus a lot on the Alternative Investment Fund as compared to the PMSs and mutual fund. Within Alternative Investment Funds, our commitments would be in the region of Rs15,500 to 16,000 crores. The amount which is drawn down by clients is Rs11,300 crores, which would make us possibly the largest player on the Alternative Investment Fund industry. The other parts of the business which is around corporate finance, estate and tax planning and the NBFC which is a lending business, essentially serve as conduits to our wealth and asset management business as supporting levers to enable us to service the clients on a holistic basis, so that is pretty much from a business perspective. In India, currently from a fee perspective, clients look at distribution, advice, and discretionary asset management fees and execution fee all pooled together. We are very well aware of the fee they are paying whether they are coming into an Alternative Investment Fund or in the mutual fund and pretty much are broadly okay with the fee whether it is coming through either advise or it is coming through distribution fee or is coming through brokerage. On the model itself, we do not specifically only have a revenue target for every banker. Bankers' dashboard is essentially made up of three big line items, so one essentially is the assets or the book he is able to build up, second is obviously the quality of assets in terms of what are the assets which, for example, we differentiate between money market instruments and other mutual funds or Alternative Investment Funds where the client is most likely to have a longer tenure of investing, and third is the revenue, so these are the three combinations which essentially enable the performance of a Relationship Manager.

In terms of the peak capacity, really if you see our business assets are increasing two folds in two segments, one is money which is new to the industry itself. Now, new money to the industry comes out of either sale of a business where a promoter is exiting part of his liquidity and then ends up with a new pot of money, which he is not yet decided to invest in another business; or let us say either could be sale of property or sale of stock options and so on and so forth, so this is money which is new to the industry itself. Second kind of money is obviously money which we are moving from competition or where a client has decided to start with us whereas earlier he was dealing with other players. We have seen a big growth in both the categories. In the first category, obviously I think there has been a great level of activity for the last six to seven years. The second activity is obviously largely driven by the number of bankers you add from your competitors because that is the best way to access the client.

In terms of where we are in terms of the peak capacity, I think that is a very good question. We essentially run something called Relationship Manager build-out model and we typically see the Relationship Managers breaking even somewhere in terms of assets between the 18th to the 24th month, and between 24th and the 60th month, they are pretty much more into a good degree or 60th to 70th productive percentile and north of four-and-a-half to five years, they become super productive, and if you see the vintage of our team, the operating leverage will, if you see the RM vintage, our average vintage is around about two-and-a-half to three years, so the real curve in terms of the three to five-year increase is something which we are really looking forward to because a large part of our team has come in over the last two-and-a-half to three years and most of them have already crossed the phase of breaking even and becoming profitable, but over the next two to three years, we see them really kind of scaling up, so as such the larger part of the team, the RM vintage is in the region of three to three-and-a-half years. For the older guys, the attrition continues to be next to negligible, of 70 to 75 senior bankers over a period of seven to eight years, we only lost a couple of bankers and that obviously allows your platform to be fairly steady and stable.

Pavan Ahluwalia: Thank you very much. One quick follow on that and that short would be greatly appreciated I think by all investors, if I look at the assets overall that is obviously slowing down as you have expected on a high base, but the AIF piece has really grown very significantly and that is bound to be much higher margin than the overall revenue margin. Also at a pretty high base on AIF now relative to what has been seen in India so far and you are certainly the leaders in the industry, any thoughts on how you are able to grow the AIF piece from here either in terms of new products, people have not seen before or what is the vision around that piece?

Karan Bhagat: I think there will be a lot of innovation on the Alternative Investment Fund space and it is actually happening through two or three reasons. One I think we are getting a great degree of new independent managers who have got proven track record for five, 10, 15 years moving out of their own comfort zones either sitting on the mutual fund platforms or otherwise and wanting to manage money independently and they obviously look to distribution platforms like us to partner with to go out and kind of raise money from clients. They are able to kind of do a lot of innovative structuring either on the construction of the portfolio or possibly on the fee structure or so on and so forth. For example, we launched a manager recently where the profit share was only above the performance of the CNX 500, so there was a little bit of innovation on the fee structure, so I think innovation will guide the growth of the AIF market in a very, very large way and I would tend to believe that is only the start.

If you see across the world, I think alternatives as a broad category, and I am using the word loosely –alternates, has grown to become among the largest kind of category and there is fair degree of tax clarity now over the last year to year-and-a-half which was not there earlier and I think that together with the ability to innovate will lead to a lot of growth in this category over the next three to four years. As a category, if you look at equity and real estate and credit even if I exclude category one and Alternative Investment Funds, it is about $10 billion industry compared to mutual funds and removing money market funds and short-term funds, will be still about only 5% of the money in the mutual fund category, so I think it has got a lot of space to grow.

Moderator: Thank you. The next question is from the line of Sunil Tirumalai from Credit Suisse. Please go ahead.

Sunil Tirumalai: Sir, I have couple of questions. Firstly, on the demerger and the listings while I hear you that even earlier you had arm's length transactions related party between the entities, I mean you would agree that there will be some loss of soft synergies, right, for example, may be the wealth management business was using your research product or that would have been lot of close linkages between your capital markets team and the NBFC team that the lending team and now when split everything into three independent businesses, will there be any loss in franchise or loss in those synergies and working together, if you could elaborate that?

Nirmal Jain: I do not think there will be any loss in franchise as such and loss in synergies, as businesses grow larger, all businesses need independence and all these common facilities like CFO, CTO, all the departments, and the technologies that I use are very different; there may be small cost savings if you work together under one roof, but I think it is very insignificant in the overall scheme of things and the benefits far outweigh the small synergies of cost. The businesses have their own critical mass and they can deploy it, have their own support functions and the facilities, so it is not significant at all.

Sunil Tirumalai: Just one more clarification, so the brand name IIFL would it be owned by somebody or will be shared, just wanted some clarity on that?

Nirmal Jain: IIFL brand is owned by the holding company as of now and there is a license to use it without any cost with these two entities. Now, once they are three entities all of them will be using the IIFL brand.

Sunil Tirumalai: My next question is to Karan, Sir, just wanted to understand how do you think if SEBI eventually pushes this regulation of splitting the advisory and distribution functions, how do you see the industry and yourself will look at it, it seems quite a structural change if that does happen?

Karan Bhagat: To be honest, there is a circular which came out roundabout four weeks back and we have had an opportunity to interact with the regulators on the same and other industry participants also, so the regulation in the current form essentially suggests that if you do either advisory or brokerage or distribution, you cannot do the other. As of now, for the last one odd year, we have been organized in a way where the advisory business and distribution business are distinct. In case the circular was to come through in its current format, I think more or less all of us will be forced to become brokers as opposed to becoming advisors and whatever advisory business we intend to do whether in the format of asset allocation, investment management, all of that essentially will happen only if the client signs a discretionary mandate with us which will happen through the portfolio management umbrella, so really in that sense the business will be reorganized in three formats, one is the financial product distribution, brokerage, and the discretionary portfolio management business.

Today, we are four which is brokerage, financial product distribution, portfolio management, and advisory. From a revenue stream today, clients hardly pay any advisory fees, so if you look at our revenue stream less than 0.1% of our fees would be coming from advisory, so from a revenue impact it will be negligible, but from an offering perspective we may have to move some of our clients from advisory to discretionary, so I really do not see a very large impact if it comes in the current form, but whether it comes in the current form or not is something which we will have to wait and see for the next three to six months, but we are fairly well-organized from a structure perspective either way.

Sunil Tirumalai: Does it help that you also manufacture some of your own products?

Karan Bhagat: World over actually if you see, US being the best example where you have seen a large part of the business over many, many years with the regulator allowing both to coexist which is distribution and advisory. Over a large period of time, we have seen 40% to 50% of the assets actually translate or migrate from brokerage to advisory and in that context I think having three or four things in-house has been the most important. One is obviously having your own innovative products on the asset management side that makes a distinctive advantage because you can offer a preferential fee structure for clients who convert to advisory.

Second, the concept of an all-in-fee where essentially we are able to subsidize the transaction fee on account of the advisory fee has again been a very big operating lever for moving clients from distribution to advisory. Unlike most other competitors, we have the advantage of having a brokerage license within the wealth business itself. Third operating lever has been the NBFC where you essentially have been able to help clients borrow up part of money against their portfolios at fairly attractive rates and these three things put together being within the same business will give us a fair competitive advantage in case these regulations come in, to be able to slowly move clients from distribution to advisory, if that is what is required. In the current format, it will be more distribution and discretionary as opposed to distribution and advisory.

Moderator: Thank you. We have the next question from the line of Saurabh Dhole from Trivantage Capital. Please go ahead.

Saurabh Dhole: Firstly, on the corporate restructuring, what kind of timelines are you looking at?

Nirmal Jain: It requires regulatory approval and NCLT approval which is now surrogate for High Court and then again other regulatory approvals, it can take about 8 to 10 months, but in the scheme you provide for an appointed date, so whenever the approval comes then you recast your balance sheet and it is effective.

Saurabh Dhole: On your NPAs in the construction book, there has been a very sharp increase if I may call it, so I just wanted to understand as in the QOQ movement moving from 1.4 to 2.3, so if you could just elaborate on the granular details of this incremental growth in NPAs?

Nirmal Jain: Construction finance, they are basically builders, now we are on 90 day provisioning and NPA recognition norm, so even if people have temporary cash flow problems it will be recognized as NPA. There are some chunky cases in this which had turned NPA in this quarter, but in all these cases typically we have adequate collateral and we should be able to recover our money - either the borrower itself regularizes or in an extreme scenario we'll liquidate the collateral and get it, but as far as accounting is concerned, if the interest is not paid for three months, it becomes an NPA.

Saurabh Dhole: In terms of the mix between affordable housing builders and non-affordable housing builders any sense on that?

Nirmal Jain: Incrementally, it is predominantly affordable housing.

Prabodh Agarwal: Total home loan AUM is Rs7500 crores and out of that about 20% of the incremental and about 10% of this is affordable, it is about Rs800 odd crores.

Nirmal Jain: Do you want to know the construction finance to affordable category and non-affordable category, right?

Saurabh Dhole: Exactly, I want to know the mix between affordable and non-affordable construction NPAs.

Nirmal Jain: First of all, non-affordable itself is not very clearly defined term, but supposing we look at the premium residential projects, or maybe in the larger cities, projects which are of higher value, -most of the NPAs are from the larger projects. But incrementally we are doing more of smaller projects but these are loans which we would carry forward for some time.

Saurabh Dhole: Sir, just one last question, on the CV book the growth rate though obviously better than what we have seen in the previous quarters, but overall with respect to the rest of the players are you of the opinion that you are growing a little more cautiously than the others?

Nirmal Jain: I do not think so because our growth in last quarter was something like 14% QOQ, so it is recovering from the cycle. I have not really compared with the numbers of other competitors in commercial vehicle segment, but we'll definitely look at that and then probably internally we can understand whether we are growing in line with the industry or slower, but the commercial vehicle cycle will revive for sure, collection has improved and also the volumes have picked up very significantly; it has passed through demonetization, then there was the BS-IV norms, then GST, and I think last quarter sector did very well.

Saurabh Dhole: In the rest of the segments, are you seeing some pressure points which have emerged very recently?

Nirmal Jain: In this segment?

Saurabh Dhole: In your entire loan book, any other product segment where you are seeing some kind of asset quality pressure or any collection-related pressures?

Nirmal Jain: If you really look at our NPAs, we give the product wise or category wise details, then there's a slight spike in the construction finance and real estate book that we have already spoken about, the second is on SME segment, there our book is growing and because we are now focusing on smaller ticket loans which is just about 10 lakh rupees, so there the 90 day recognition many times create little bit of collection problems; but of course it is covered fully by pricing as well as our collection. Other than these two if you look at all other segments they may have improved actually.

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

Nishchint Chawathe: A couple of micro-questions, one was on the NBFC side the other income, just curious if there was any chunky items this quarter?

Nirmal Jain: Not really, but let me look at the numbers, so on a smaller base they may look chunky in terms of the percentage, Prabodh will give you more details

Prabodh Agarwal: Nishchint, if you look at other income, it was up some 55% QOQ and this is due to few reasons; one, there is a sharp increase in our disbursement volume growth in retail products like home loan, gold, CV, MSME, MFI. If you look at the retail volume growth, it was almost 100% YOY, so correspondingly my processing fee etc. have also grown that way, that is not reflected in the AUM, but the disbursement is very high. Secondly, there is a jump in the insurance income because many products now we are bundling, the insurance is in bundle with many products including home loan, with CV, with MFI, SME all these products are now being bundled with insurance, and therefore, jump in insurance income. The third is there is the capital market lending related fees have gone up because that again there the lending have gone up and therefore the fee income has been high on the IPO side.

Nishchint Chawathe: Okay, capital market related lending has fee income?

Nirmal Jain: What happens there is some small processing fee when we do the IPO also, so some part of it goes in interest, but some part of it might go as processing fee.

Nishchint Chawathe: Would you guide us for a similar run rate going forward or would you say that look there is some one-off kind of?

Nirmal Jain: See, because our growth is more driven by smaller ticket loan in MFI and MSME, where there is a relatively higher component of fee income as a proportion of total income, so you are right that the other income should now maintain higher levels as the retail business grows more in proportionate terms.

Nishchint Chawathe: NPAs if you could give the ratio on a like-to-like basis?

Nirmal Jain: NPAs are there on the slide, like to like basis or you are saying 90-day basis?

Nishchint Chawathe: Yeah, 90 and 120, I think YOY was 120.

Nirmal Jain: I will not have details readily, but on a like-to-like basis things would not have worsened in fact most of the asset classes, things have improved. We do not have those numbers, but if you look at the trend and things would not have changed, we can get this number out and send it to everybody.

Nishchint Chawathe: The other thing is on the developer loan NPL rise just curious how many accounts would these be?

Nirmal Jain: Which have incrementally become NPA in this quarter?

Nishchint Chawathe: Yeah, that is right.

Nirmal Jain: About four to five accounts.

Nishchint Chawathe: If I look at the overall your capital market related income, that has been sort of almost flat for last three quarters, so I mean I would have thought that this quarter should have been far better quarter or income should have been much higher, so I was just wondering whether we are missing any trend?

Nirmal Jain: When we compare on a YOY basis then there is some decline in the depository income and our delayed payment charges income. Also, the investment banking in cross selling income, sometimes become lumpy because of the way they are booked and accounted. Sometimes volume growth happens that is more intraday and less delivery days, so that also causes income to grow at a slower pace. But there are various components of it, also insurance and all those other businesses we have scaled down significantly and that has also resulted in cost savings.

Nishchint Chawathe: Yeah, but I would assume that broking itself is a fairly large component in capital market activities?

Nirmal Jain: There is no doubt about it, but as I just said that on a like-to-like basis there are various components of depository income, delayed payment charges, investment banking and cross sell; also there is commodities and currency brokerage, so there are several components.

Broking will be significant, but will not be the dominant part of it because there are several small, small components in that.

Nishchint Chawathe: Just one final question and this is for Karan, just trying to understand two things one is, a, seasonality in the business, and B, more importantly what happens if market crashes or market remains weak for a fairly long period of time, your ability to cross sell real estate or some of the other assets?

Karan Bhagat: I will answer your second question first and I will come back to the first, so typically what we have seen over the last, I have been doing this for the last 20 years typically what we have seen in case of steep market corrections, typically unless you have done really something fairly aggressive or even some disproportionate allocation to something, you do not end up losing too many clients, most of the clients typically shift their assets away from equity to fixed income or alternate products. If you see as a firm today on gross Rs. 100, we have close to around what Rs. 53 to Rs. 54 in equities and roundabout Rs. 35 to Rs. 38 in fixed income, at Rs. 3 to Rs. 4 in real estate, and Rs. 4 to Rs. 5 in other assets; so as a firm across client portfolio the asset allocation is fairly tight and the volatility which we see on portfolios is not exactly similar to what we see in the equity market, it is substantially lower, but yes, from a continuous ability of the clients to participate in newer ideas can potentially come down a bit, unlikely to lose assets, but definitely there may be a little less ability to see velocity of sales in that sense. Similarly, on the seasonality of the business, I think what may be potentially seasonal is the gross sales number, now obviously out of the distribution revenue, part of it comes out of gross sales for the quarter, part of it is recurring trail fee-based income, so the recurring trail fee-based income is not really something which is that seasonal. The process number can be potentially seasonal, which makes up typically 30% to 40% of the distribution fee and that might come of 15% to 20% in case of a prolonged correction in the markets.

Nishchint Chawathe: When I meant seasonal I meant more on a quarter on quarter basis, is it something that fourth quarter is strong or anything of that sort?

Karan Bhagat: Not really, it used to be but now at this size and scale, it is pretty much now fairly evened out, if you see the last six to eight quarters in that sense it has been more a QOQ kind of growth, it has not really been a third quarter, fourth quarter kind of phenomenon.

Nishchint Chawathe: Just one final question and lot of other finance companies or NBFCs are kind of setting up or trying to setup a wealth management vertical, have you seen competition, A, in terms of on the employee side where they are kind of poaching employees, and second thing is, have you seen genuine competition in the ultra-HNI segment that you are catering to?

Karan Bhagat: We definitely see competition both in terms of employees as well as in terms of the platform. Employees, I think as I said both our senior bankers as well as our product and investment teams have been fairly static and attrition has been super low, I think a part reason for that, as Nirmal spoke earlier, is the very strong entrepreneurial culture, and a lot of our senior relationship bankers as well as senior employees owning stock in the firm and being around for the last seven to eight years. I think in some ways it is something which is expressed very strongly as a culture and we are still continuing to be able to attract conversely a lot of people from other platforms to join. Over the last six months, we had a couple of very interesting teams join us and we expect a couple of very interesting teams to join us over the next three to four months also. In terms of the platform itself, there will be obviously newer kind of process coming. As of now, we have not really seen a very strong new institutional player in the wealth market, but it cannot be absolutely ruled out because from a business perspective really, one, obviously people are extremely, extremely important, and secondly, getting the platform right also needs today a lot of time, energy as well as capital investment, so it is not easy to get the full formula right, but as of now we have not really seen a large player come in, but we have got three or four names as you are all well aware of putting in a lot of energy, time, and capital into the business, so we will have to wait and see over the next six to nine months how these platforms shape up.

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

Shiv Kumar: Sir, my first question is with regard to the NBFC, now that we have seen that the microfinance loans have reached 574 crores which is a growth of 42% quarter on quarter, what are the near-term targets you have for this particular segment?

Nirmal Jain: It is on a very small base, so it can continue to grow at a very fast pace, I mean difficult to put a quantitative target, we cannot make a forward-looking statement on that, but our distribution network -our footprint is so large, the whole idea of acquiring a small company was that we can expand the leveraging in our distribution network, our managerial as well as our branches etc. It will continue to grow at a faster pace at least in the next few quarters.

Shiv Kumar: Sir, coming to this construction real estate segment, again revisiting the increase in the NNPA, I just wanted to understand at what stage of the construction do you actually get in, is IIFL taking the construction risk of the project also on-board or do you actually get in towards an advanced stage of construction?

Nirmal Jain: The construction risk of the project, the execution risk of the project is always there as part of construction finance, but what kind of approval risk we take is, so you know what happens is that we try and make sure that all the approvals, all the titles are in place, but under Indian law many times what happens is that even when the approvals are given, and there is a very large project in Mumbai which has become a showcase example of that, then even those approvals are challenged in the Supreme Court by saying that the concerned authority did not give those approvals properly and there also the project can get stalled, so the litigations can happen at any stage which no amount of diligence can prevent it, but we can make sure that all the approvals are in place before we lend to the project.

Shiv Kumar: Sir, my second question is related to the wealth management segment, we see that the retention yield has been given us 92 bps of which 26 bps is from the fund-based activity, so this 26 bps is being calculated on the wealth NBFC assets, it is fund-based activities?

Karan Bhagat: The retention yield is being calculated on the entire asset base of Rs1,28,000 crores.

Shiv Kumar: Okay, leaving out the offshore FPI, that is it right?

Karan Bhagat: That is right.

Shiv Kumar: What explains the dip in the retention yield from 98 bps in FY '17 to currently 92 is the run rate which we are looking at on a quarter-on-quarter basis, so what explains that?

Karan Bhagat: Mostly mutual funds, so effectively mutual funds have all moved to trail, and last year the only mutual fund kind of gave an upfront recognition was fixed maturity plans, otherwise all other kinds of mutual funds which include all equity, fixed income mutual funds are all on trial basis, so FMPs have become a much smaller portion of the mutual fund mix, so that is mostly the reason for the dip.

Shiv Kumar: Is this not the steady state, Karan, can we assume that this will may be steady at these levels?

Karan Bhagat: World over retentions including fund-based and non-fund based has been in the region of around 72 to 80 basis points, so I think in the longer term, with a larger base, I think it is fair to assume 70 to 80 basis points, and typically fund-based income should be in the region of roundabout 25% to 30% of the overall revenues, and 70% to 75% should be fee-based.

Shiv Kumar: Coming to your hiring plans now that you have grown by 34 bankers over the last quarter, so in a medium-term what is the guidance like?

Karan Bhagat: It is really a function of getting some good bankers, as we have seen a lot of growth in some of the cities that we are not present in, because right now we were only there in roundabout 11 to 12 cities predominantly. We have seen six or seven cities do extremely well for us on a hub and spoke basis which we've been operating for the last 12 to 18 months, so we expect to add a banker each in these six to seven cities and Mumbai, Delhi, Bengaluru, Kolkata, Chennai, I think we would end up adding over the next six months another 35 to 40 Bankers, so I think in total roundabout over the next six months roundabout 50 bankers is what we are potentially looking at.

Moderator: Thank you. We have a follow up question from the line of Viral Shah from Credit Suisse. Please go ahead.

Sunil Tirumalai: Sir, just a clarification again on the demerger process, in the past when we have seen other listed companies go through this, we have noticed that there would be a period when the Hold Cos, real estate, and that is nothing trading for a while and then the other businesses list, is that how it is going to be where there could be a gap in trading?

Nirmal Jain: As we said at this point in time, the way we have envisaged, there will not be any gap in trading of the company, but what will happen is the NBFC will get merged with Hold Co, so Hold Co will continue trade and at some point in time that will become the NBFC that is being traded, and the other two companies might get listed in a week or two. Typically, I think this gap, if you manage all the compliances properly, can be about 10 to 12 days. What will happen is Hold Co on a particular record date will become a NBFC, but may continue to be listed and the other companies will get listed with a gap of one or two weeks, but this will happen maybe eight to 10 months later when all the approvals are in place.

Sunil Tirumalai: Secondly, Prabodh, going back to the question on the high other income, what we notice is that there actually seems to be some restatement as well because even in the previous quarter numbers other income is higher than what it was reported in previous quarters presentation, so is there some reclassification from revenue from operations for other income?

Prabodh Agarwal: Yeah, that is the reclassification which is happening. We had a change of our auditors in the last quarter. Deloitte has become our new statutory auditor, and therefore, they have certain views on the classification of various income and expense items, so therefore, we have had some regrouping in the last quarter and as well as in this quarter and I suppose that there will be some reclassification in the next quarter also, but probably from the first quarter FY '19, there should be no more, all the major classification should have happened in this one or two quarters.

Sunil Tirumalai: Last question, the home loan segment within the lending book has been growing about 27% to 28% total, where do you see that going up to over the next say two to three years and what would that mean for your margins and your ROAs? thank you

Nirmal Jain: Our market share in the home loan or the mortgage market is very miniscule, but if you look at our distribution network, it is much bigger than what our market share is in home loans, so logically this business should continue to grow at a faster pace. What it does to margins is that in the short-term, it impacts our margins downward, it affects our NIM, as you can see that the fall in cost of borrowing is not fully reflected in NIM primarily because home loan is becoming a larger share of our portfolio, but given a 12, 18 or 24 months gap, it works out very well, there are three to four reasons for that, one is that home loans you can get a refinance by NHB at a fairly attractive rate and so you book your income as well as you release your capital, you can sell down your portfolio to banks because significant part of our home loan portfolio classifies as priority sector and even if it is non-priority sector, there is very good demand for home loan portfolio.

Thirdly, in home loans and HFC, your capital adequacy requirement is lower, so it is just about 12% as compared to 15% in NBFC and also most of the home loans that we do are small ticket home loans, our average ticket size is just about 22 lakh rupees, so they classify for a risk weightage of 75%, so effectively this 12% capital adequacy becomes 9%, so that also gives an advantage increase to leverage more, so from ROE perspective, it is good but in the growth phase it might have some dampening impact, but as the book becomes larger and stabilizes then it will reflect very well in the ROE.

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

Nirmal Jain: Thank you so much everybody for being patient and if you have any more questions, you can always write it to Pooja who handles our investor relations and you can be in touch. Thank you very much, bye, and good day.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of IIFL Holdings Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.