IIFL Finance Limited

(formerly IIFL Holdings Limited)

Consolidated Financial Results – Q1FY20

Conference Call Transcript

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Management

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

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

Mr. Sumit Bali – Chief Executive Officer, India Infoline Finance Limited

Moderator: Good day ladies and gentlemen and a very warm welcome to the IIFL Finance Q1 FY2020 earnings conference 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 call, please signal an operator by pressing '*' then '0' on your touch-tone 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 Agrawal: Good afternoon everyone. On behalf of team IIFL, I thank all of you for joining us on this call. I am Prabodh Agrawal – CFO; accompanied by Nirmal Jain – our Chairman; R. Venkataraman – Managing Director; and Sumit Bali – CEO of IIFL Finance. I will now pass the mike to our Chairman to comment on the overview of the group's strategy and plans.

Nirmal Jain: Welcome to the call. I shall take a few minutes to share my thoughts on current macro environment as it is relevant for our business and what our strategy going ahead is. Globally we are seeing negative yield on 10-year and 30-year government bonds and that pool is getting into trillions of dollars. A very unusual phenomenon, but it suggests impending recession or assured liquidity which is coupled with risk aversion. Therefore, conservative investors are not only compelled to reconcile with negative return on long-dated security but also risk of huge MTM loss if interest rates were to rise even a little.

In contrast, India has still a long-term growth story and has the ability to generate good long-term returns. So, one would have expected India to attract huge capital given very low or negative return outside. However, at least in the near future, investors are concerned about economic slowdown here.

IIFL Finance is a non-banking lender, and as all of us know that NBFCs and HFCs have passed through trial by fire in the wake of IL&FS default and the 1st anniversary of IL&FS default is just about a month away, and in this last 1-year time period, we haven't seen any default of significance or anything which is major but most NBFCs and HFCs have slowed down the loan growth given their inability to raise the debt resources on reasonable terms.

RBI and government measures will have far-reaching implications for the industry's future. In particular, the onward lending scheme can be a game changer and also of course, there is a scheme to underwrite the first losses up to 10%. This can also be a significant booster.

Historically, NBFCs grew with two different strategies: 1) Opportunistic by wholesale funding at high-interest yield to developer and real estate sector and loan against shares to promoters. 2) By complementing banks' effort in fulfilling the credit gap for productive activities as well as for retail consumers.

The onward lending scheme clearly is not to bail out. It is for future loan. It is not to ease liquidity stress. The scheme is very clearly to stoke growth and is for future lending. If we see all the schemes and the measures that the government is doing, it is very clear that RBI as well as all the banks and government recognize the indispensable role that NBFCs can play in filling the credit gap and delivering last mile credit for growth and that is where they can partner and complement banks' efforts. So, other than onward lending, sometime ago, we also saw a co-lending scheme. So, I think policymakers also realize that the economic slowdown to some extent is caused by NBFC squeeze.

The sector has passed through a kind of crisis and a crisis should not be wasted. At IIFL Finance, we have sharpened our focus on core retail loan assets. We are reducing our exposure to real estate sector. Our strategy is to bring it down to single-digit share in our total loan AUM and that too focused on affordable projects, especially where we can be a partner for home loans to end-user buyer. We have ring-fenced all the real estate projects and have funded and also adequately provided for. So, our 3800 crores loan book in our NBFC carries more than Rs. 400 crores of provision, although the current GNPAs are just about 139 crores. So, we were a little cautious and making sure that all the projects basically are monitored carefully and we don't end up with any additional losses there.

But other than that, on the retail, the core assets products are where we have seen a significant volume growth or significant AUM growth. On a YOY basis if you look at our loan AUM, there is a 28% YOY growth in this quarter in the core retail assets which are focused for growth including home loan, the small business loan, microfinance loan, and gold loans. Even in business loan, there is a small negative growth, but then if you break it up into the large-ticket LAP and the small-ticket business loan, then the large-ticket LAP has de-grown but the small-ticket loan which is our focus has grown positively.

When we look at our GNPAs in June over say previous quarter or previous year, you might see a marginal increase, a small increase in all the retail assets. There are two reasons; one is our assignments have increased significantly, and when you assign it to the bank, obviously they will not take any delinquent assets. They will take assets which are good performing, and to that extent, if you look at our GNPAs on the loan AUM, they are lower and there is a marginal dip also because of seasonal nature of the business, in the June quarter typically, NPAs are slightly higher than the March end. This is an industry-wide phenomenon, particularly for the home loans.

Our operating cost has gone up significantly, but that is in line with the growth in our branch network and people. Our branch network also has grown by almost 500 number of branches, which is close to 25% to 30% increase, and there is a similar increase in our number of people also. These growth initiatives were taken about a year back; we have completed them. We have increased our footprint to make sure that our retail asset growth remains robust. Now, I think, is the time to make sure that we derive the operating leverage, we sweat these branches and improve productivity of these branches. We don't have plans for expansion at least in the near future.

In terms of liquidity, if you look at our balance sheet, which is given in our analyst presentation, we have cash in bank of about Rs. 2000 crores. Besides that, we had Rs. 2000 crores of committed funding or credit lines. We are quite well placed or reasonably comfortable in terms of liquidity and our ability to fund the near-term growth as well as all the obligations that we have.

The market sentiment can swing from irrational exuberance to feeling of eternal gloom, but we remain focused on our retail business, and in this crisis, we have not only sharpened our focus on the core products but also taken several steps to reduce operating costs and sharpen our technology edge as well. And we hope that as things recover, we are well placed to seize the opportunity.

With this, I will pass it on to Prabodh to take you through the financial numbers in greater detail and then we will take up the Q&A.

Prabodh Agrawal: IIFL Finance net profit was Rs. 181 crores in 1st quarter FY 20, up 7% Q-o-Q and down 7% YOY. This is after adjusting for one-off gains on sale of CV business in the last quarter. When we just consider profits from continuing business, that is Ex-CV businesses, the net profit of Rs. 181 crores, was up 43% Q-o-Q and 2% YOY.

Loan AUM grew 19% YOY and was flat Q-o-Q at Rs. 34,920 crores. Our tier-1 CAR stands at 18.4% and total CAR at 22.1%. Primary drivers of our AUM growth are small-ticket home loans which grew by 33% YOY, gold loans which grew by 46% YOY, business loans which grew by 1% YOY, and within that, small-ticket MSME loans grew by 13% YOY while LAP declined by 4% YOY and microfinance loans which grew by 112% YOY.

On the other hand, construction and real estate finance and capital market loans declined both on Q-o-Q and YOY basis. In home loans, our focus remains primarily on small-ticket loans to the salaried and self-employed sections. The fastest growing segment in home loans is the affordable home segment or Swaraj loans with average ticket size of 13 to 14 lakhs.

IIFL Home Finance has been a significant player in Pradhan Mantri Awas Yojana Credit Linked Subsidy Scheme. Till date, it has provided benefits to 30,000 customers and disbursed subsidies of nearly Rs. 700 crores. The company is also expanding its footprint and currently has 120 branches across 17 states. The customer base for our HFC has crossed 88,000 this quarter.

Retail loans including consumer loans and small business finance constitute 86% of our loan book. Another strong characteristic of our loan book is the large proportion of loans that are compliant with RBI's priority sector lending norms. About 57% of our home loans, 47% of business loans, and 95% of our MFI loans are PSL-compliant. In aggregate, nearly 43% of our loans are PSL-compliant. The large share of retail and PSL-compliant loans are of significant value in the current environment where we can sell-down these loans to raise long-term resources.

We completed securitization assignment transactions, amounting to Rs. 4595 crores in 1st quarter compared to Rs. 2562 crores in 4th quarter last year. We sold down both PSL and non-PSL loans in five product categories including home loan, LAP, SME, gold, and microfinance to government, private, and foreign banks.

Our average cost of borrowing rose by 16 basis points Q-on-Q and 68 basis points YOY to 9.26% in 1st quarter. Access to long-term funding sources is still scarce, and we continue to manage the tight liquidity conditions by tapping new borrowing channels like dollar-based funding, public issue of NCDs, market-linked debentures, and assignment deals.

Of late, banks are warming up to term-loan proposals and few of our proposals with banks are in advance stages. We also expect incremental refinance from the National Housing Bank. We have been able to reprice our loans and protect our net interest margins, our NIM was at 8.25%. We currently have 2110 branches, primarily for our HFC, gold, and microfinance businesses.

Consolidated gross NPA and net NPA recognized as per RBI's prudential norms and provision as per expected credit loss method prescribed in Ind-AS stood at 2% and

0.8% of loans respectively. The NPA ratios appear higher, primarily because the loan book has declined 6% Q-o-Q and 13% YOY due to portfolio sell-downs. Provision coverage, under Ind-AS norms on stage-3 assets stood at 131%. Return on assets for 1st quarter FY20 was at 2.3% and return on equity was at 17.3%.

Some update on liquidity: We have significantly cut down our borrowing through commercial paper over the last 3 quarters. In end June, CPs of Rs. 1790 crores were outstanding which was 5% of our total borrowings. This has been further reduced to almost zero as on date.

Our funding mix is well diversified including 22% from NCDs including subordinate debt; 37% from bank term loans, working capital finance, and NHB refinance; 36% from securitization assignment; and 5% from commercial paper. We had raised Rs. 1200 crores in Tranche 1 of public issue of bonds in January this year. The second Tranche of the bonds issue is currently open.

Last month, we raised USD 100 million through ECB from EDC Canada. This is a prestigious new addition to our list of investors. We have a positive ALM whereby inflows cover or exceed the expected outflows across all buckets. We had committed credit lines totaling Rs. 1949 crores in end June.

On the digital front, 99% of the 6.4 lakh accounts boarded in 1st quarter FY20 have been acquired digitally. We have focused on back-end process, digitization through multiple innovations as well as partnerships helping us achieve process efficiencies. We have integrated new CRM with IIFL Loans app. This helps in providing better service to our customers.

On the analytics front, we continue to drive the use of credit scores and automated decisioning across products and strengthened risk mitigation by developing and deploying behavioral scorecards for upsell and collection scorecards for collection prioritization. There is increased focus on cross-sell and win back by using analytics to maximize cross-sell opportunities within the group and by deeper integration of cross-sell campaigns with CRM to improve lead conversions.

New fraud scorecard is in place to eliminate fraud at pre-acquisition stage along with regular development and fine-tuning of fraud triggers to manage fraud at both pre-disbursal and post-disbursal stage.

With that, now we will open the floor for Q&A.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles.

The first question is from the line of Shubhranshu Mishra from BOB Capital Markets. Please go ahead.

Shubhranshu Mishra: The first question is with regards to your developer financing. I just wanted a little more flavor as to how many loan contracts and out of them how many of them are in the top 7 cities and what proportion of these developer finance is still under construction and how much is ready for completion in the fiscal '20?

Balaji Raghavan: This is Balaji Raghavan here, I handle the construction finance and real estate financing for the group. To answer your questions, one is that we would have about 56 to 58 contracts which are there in the entire book of about 3800 odd crores which are currently live and running. To answer your second question is that all of these projects would be under various stages of construction. Some would be at a commencement stage of let us say 10% to 15% and some would be at a closure stage of let us say about 80% to 90% and so on. The moment the construction is completed which is let us say 100% and the occupation is obtained, the obvious result of that being is that we exit the project completely. That is where we are. As far as the percentages go, these would be equally spread across the various stages. There would be some which would be let us say 20% to 30%, some 50% to 60% and some which would be let us say 70% to 80%. So, it would be a little difficult at this juncture to answer exactly specifically the numbers as to which stage would be where but just to sort of give an overall view, this would be more or less equally spread across the various stages.

Shubhranshu Mishra: And how many in top 7 cities?

Balaji Raghavan: All of them are in the top 7 cities. We don't have much which is beyond the top 7 cities. In fact, I would reduce that further. We would have most of our exposures focused in the top about 4 to 5 cities across the construction stages.

Nirmal Jain: This is 3800-crores portfolio, then we have another 1200-crores portfolio which is also classified as part of developer and real estate which is done through HFC. Now, through housing finance, you can fund only after the approvals have been received but these are relatively smaller projects and they might be in 20 to 25 cities.

Balaji Raghavan: Here, the ticket size as Mr. Jain just mentioned would be in the range of around 10 to 12 crores where these are very small developers and very small projects and these might be let us say in tier 2 cities. However, the bulk of the portfolio which I am talking about, about 3800 crores would be in the top about 4 to 5 cities. These being namely Mumbai, NCR, Bengaluru, Pune, Chennai. In fact, it would be about 6 to 7 cities.

Shubhranshu Mishra: My next question is with regards to your gold loan as well as MFI. Is there any pin code correlation between both the businesses as in the branches are coexisting or there are separate branches and you are targeting different target market segments?

Nirmal Jain: Gold loan business we started about 9 years ago and microfinance we acquired the company and in a way practically we got full control and started expanding only 2 years ago. We are trying to map out and have the synergies wherever physical locations can be together, but as of now, the gold loan branch network is much wider.

Shubhranshu Mishra: What I am trying to understand is the future synergy that you find between both the businesses. Will the branches be co-located?

Nirmal Jain: The expansion that we have done in the last 1 year, there are a few branches that are co-located, but one difference is that in microfinance, we go rural, but in gold loan, we are into tier 2 and tier 3 towns and cities. So, there are some locations where they can have co-location advantage but it is not something which can be a given. That is in some cases but not all cases.

Moderator: The next question is from the line of Dipanjan Ghosh from Kotak Securities. Please go ahead.

Dipanjan Ghosh: First, I wanted to get a sense of the assignment income booked in this quarter and also FY2019.

Nirmal Jain: In this quarter, it is 32.4 crores. Full year is 68 crores.

Dipanjan Ghosh: Also, just to get a sense of the book that you sold down in the last quarter, how much of the receivables are still pending and how much have you already received?

Nirmal Jain: 1100 crores is still outstanding and I think the total transaction is 2400 crores, so more than half is received. But there is a monthly payment schedule, they are paying as per the schedule.

Dipanjan Ghosh: One last clarification. If I am not wrong, the listed entity basically holds around 85% of the NBFC business. Am I correct?

Nirmal Jain: That's right. 85% is listed entity and 15% is CDC. And going back to your question about Indostar, the receivables come to the escrow from where we pick it up. So, most of the premium and the other amount were paid upfront. These monthly instalments come through normal repayment of the loans also.

Moderator: The next question is from the line of K Sivakumar from Unifi Capital. Please go ahead.

K Sivakumar: Can you take us through the movement in the GNPAs from the developer or construction finance segment as to what was the number you started with, what was the resolution, and what were the recoveries you made, and finally what is the number you have ended with?

Nirmal Jain: There are many cases and if you see from last quarter to this quarter, it has fallen from some 4.4% to 2.9%. Primarily, some of the developers who might be in the 90-day plus, they might come back. Some of the cases have been resolved where they are acquired by some other developer with some more collateral. Totally if you see, then there is a decline of about 140 crores or something. One or two cases are asset sale also.

K Sivakumar: Last quarter you said that you started with around 418 crores and recovered about 210 crores. So, you were left with something like 205 crores. Now that number has fallen to what number now? Has it fallen to 150 crores?

Nirmal Jain: 130 odd crores is the total number.

K Sivakumar: So, 205 cores has become 130 crores over the quarter, right?

Nirmal Jain: Right.

K Sivakumar: Any upgrades or recovery that you got from the erstwhile write-offs you did?

Nirmal Jain: Not in this quarter actually. Maybe last quarter we had some but not in this quarter. Nothing of significance.

K Sivakumar: Sir, this 130 crores is spread across how many projects? How is the lumpiness in the GNPAs?

Nirmal Jain: Four projects.

K Sivakumar: Going forward, what is the outlook? Are you seeing additional stress coming into the books or do you think this is the bottom?

Nirmal Jain: I think we have seen the bottom. Things will start recovering. Last time also I said that and we have seen some recovery this quarter. As I had explained in the last quarterly con-call that our exposure is not in the central Mumbai where I personally see stress continuing for much longer but we are mostly in the suburbs of the larger cities. If you see our exposure in Mumbai and Delhi-NCR, it is all in (Mumbai) Borivali to Vasai or Thane or Bohisar or maybe Andheri onwards, and there we are seeing that the projects if they get executed, then they sell. They sell at a price but they sell. And other cities like Pune and Bengaluru, they are also doing pretty okay. Not that the sales are booming, but they are not as bad as if everything is over. They are moving.

K Sivakumar: So, you don't expect additional stress to be added to the GNPA number?

Nirmal Jain: Yes, either it will remain at a similar level or might improve over a period of time.

K Sivakumar: Since you have taken complete write-off, what is the time frame you expect over which you can see some recoveries coming back?

Nirmal Jain: In some of the write-offs, you will see some recovery. SARFAESI and all those things are on, so in the next couple of quarters, you should see some recovery.

K Sivakumar: Sir, since there are two segments within this developer finance, one is for the HFC support wherein you do more smaller-size loans and all and the bigger-ticket size that happens in the NBFC. So, you will continue the HFC but you will scale down the NBFC part, right?

Nirmal Jain: NBFC we have not done anything incremental, but yes, you are right. But even HFC in the last quarter or last couple of quarters has been slowed down, but if you ask me for a longer term strategy, that might continue and the NBFC will move to the fund structure. As you are aware that we have a fund set up through our Wealth subsidiary which is Asset Management Company- AIF structure, most of the larger projects might get funded through fund and the smaller projects we can take it on our balance sheet.

K Sivakumar: Sir, I had one question on the business loss. We see that there is a slight bump up in the GNPA number. Anything that is concerning over there or it is just a seasonal phenomenon?

Sumit Bali: As we have said in the beginning, typically we see that the Q1 numbers are slightly higher than the Q4 numbers. That is what is at play here and typically these do get resolved over the next 2 to 3 quarters, and given the fact that the business within the business loan which is growing is higher-margin business loan, I think we have control over the book and you should see the number moderate from hereon.

Moderator: The next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Sir, my first question relates to your funding thing. Is there any problem or as such growth hindrance you are facing in terms of getting your funding out of the liability profile and what sort of securitization run rate are you going to maintain going forward?

Nirmal Jain: Funding of course everybody knows that historically industry could take money from mutual fund by way of CP and also the bank term loans are more or less available on tap. That situation changed in last 9 months. To my mind, it has been the correction which was overdue. What triggered is a different point of debate, but many of these short-term liabilities are funding long-term assets as is typically the problem of finance sector which has played out world over at many different times in different countries. In a way, it is a blessing in disguise for the industry that it has been fixed. That is one part of it.

But as far as we are concerned, 85% of our loan book is retail and which after a time gap of 3 months or 6 months depending on the seasoning required, almost entirely becomes eligible for being sold out to banks and even the securitization assignments that we have done have been in the range of 9% to 9.5% and most of the banks are very willing buyers. They need these assets as much as we need liquidity. So, we haven't seen any issue there, but also I must add that recently in the last couple of weeks, we have seen that the environment is easing. Even banks are now opening up for term loans. ECBs also have started moving. What happens is the ECBs actually always dependent on the cost of funding in dollar terms and also the arbitrage cost. So, that also has become viable with the easing of policies and the way people are looking.

As I said just a few minutes ago that I think the bottom or the worst should be behind us and even the funding should become much better from here. So, all sources should be open from ECB to retail to bank loans to securitization & assignment and also the onward lending guidelines are very good because if you look at most of our assets are less than Rs. 20 lakhs, and there if banks lend to us, then that becomes a priority sector loan.

These kinds of guidelines were there before 2008 actually and I think on some committee’s recommendations they were taken away but they came back. Banks when they lend pure term loan to us, it meets their priority sector lending norms. Most of the banks are not able to meet the 40% quota of priority sector. They end up paying penalty by way of low-cost deposit to NABARD or others. I have a feeling that now that government, RBI, and everybody has become conscious, things should get much easier from here.

Sumit Bali: Just to add one more thing, overall system liquidity also has turned positive for the last few weeks. So, it is a matter of now I think just building up of confidence that liquidity will start growing.

Deepak Poddar: We are still maintaining the kind of a growth we have seen in FY19 because that is what we have said in the past that we will look to maintain this kind of growth going forward what we have achieved in FY19.

Nirmal Jain: If you look at our presentation, we have divided our asset classes into core and synergistic. As far as our core retail asset products are concerned, we expect to maintain the growth.

Deepak Poddar: 25% growth is what we have seen. Is that what we are looking at going forward as well?

Sumit Bali: If you see even on quarter on quarter, the core growth has been positive at 2% to 3%. The synergistic segment has declined. We will continue to grow that business. How much is something as the liquidity pans out, we will look at that.

Nirmal Jain: I think in the core loan assets that we have, we should look at, on annualized basis, 15% to 20% volume growth.

Deepak Poddar: And your core asset would be microfinance, small businesses, gold, and home loan, right? These are the four sectors?

Nirmal Jain: That's right.

Deepak Poddar: Due to PSL, because a large portion of our loan book would be PSL compliant, how much impact that has on our NIMs?

Sumit Bali: Overall if you see these four core growth segments, the home loans, microfinance, MSME loans, and gold loans these are all well above 7% to 8% NIM products. Home loan typically is lower NIM. So, on a combined aggregate basis, to maintain NIMs between 7% to 8% is something which we are confident of.

Deepak Poddar: This quarter it was about 8.5%.

Sumit Bali: This quarter it was higher but 7% to 8% sustainable is what we think.

Deepak Poddar: Even in terms of credit cost, this quarter was quite low, I think maybe also contributed due to your sale of asset, the CV Finance. Is this the going forward kind of credit cost that one must look at?

Nirmal Jain: If you look at our last 12 years, our loan losses and provisions have been 0.4% every year. Last quarter was an aberration where we took a larger write-off because we had a one-time gain. We tried to use it and took write-offs and higher provision in our real estate exposure. I think, under normal circumstances, in a year, our loan losses and provisions should be around 0.4% to 0.5%. Last quarter was an aberration.

Deepak Poddar: This 0.4% to 0.5% per annum, right?

Nirmal Jain: Per annum, that's right, which is in line with what you see in this quarter.

Moderator: The next question is from the line of Aswin Balasubramanian from HSBC Asset Management. Please go ahead.

Aswin Balasubramanian: My question is with regard to the slide on ALM. In that slide, in terms of the inflows which you have mentioned, is that coming only from the loan book or does that include the securitized portion as well?

Nirmal Jain: This slide is based on - if you don't do anything incremental and you get your repayments ofnexisting loan assets as per the behavioral pattern what we are seeing and all the contractual liabilities were to be repaid, based on that.

Aswin Balasubramanian: Are the off-balance sheet like both the liabilities and assets are included in this or it is only the on-balance sheet?

Nirmal Jain: It includes the committed off-balance sheet inflows also.

Aswin Balasubramanian: If I look at let us say 1-year bucket, it comes to about 15,000 crores. This is what you have mentioned as inflows. In that, what would be from the repayments and prepayments combined and what would be the remaining number because if I divide that by the loan book, that is about 60% of the loan book. So, I am presuming that this includes the unutilized bank lines and other stuff also in this 15,000 crores.

Prabodh Agrawal: The major inflows will include the term loans that we have contracted. So, the total lines of committed credit is 1949 crores that is there. Then, it will include the inflows that we expect from the securitization deal. So, we have about 11,000 odd crores of securitization which we have done. A lot of these are short term, why you see in the first less than 1 year bucket is because about 4000 crores of gold is outstanding which will all be received in the next 6 months. That is what is reflected in the cash flows.

Aswin Balasubramanian: So, basically this inflow and outflow both include the securitized portion also. That is the understanding, right?

Nirmal Jain: Yes, that's right

Moderator: As there are no further questions, I hand over to the management for their closing comments.

Nirmal Jain: Thank you all of you, and as always, if you have any more queries/questions, please feel free to get in touch with our Investor Relations. Thank you so much. Have a good day.

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