IIFL Holdings Limited

Consolidated Financial Results – Q2FY19

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

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

Moderator: Ladies and gentlemen, good day & welcome to IIFL Holdings Limited 2nd Quarter Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' 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, 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 Agarwal, Group CFO, accompanied by Nirmal Jain, our Group Chairman; R. Venkataraman, Managing Director, Sumit Bali, CEO of IIFL Finance; & Karan Bhagat, Managing Director of IIFL Wealth Management.

I will now pass the mic to our chairman to comment on overview of the group's strategy and plans.

Nirmal Jain: Thank you Prabodh, Good morning to all the participants and welcome. I will first share my thoughts about the macro environment that our company and our group works in, then broadly on our strategy for our various businesses and then I will hand it back to Prabodh for a line-by-line discussion on financials and also for the Q&A.

The economy and market are looking much better, if you were having this call say about a week back, things would have looked very despondent but now they seem much better and brighter. One of the key reasons is that crude oil prices have fallen from the recent peak of $85 to $72. In my last 30 years of experience in the Indian economy and market, I feel that crude actually matters a lot. Whenever crude prices have gone down, current account deficit or fiscal account deficit, liquidity etc. tends to look better, rupee also strengthens, and that gives more confidence to our foreign investors. But along with this, we are also seeing a few positive developments in the global market; we are seeing that the US bond yield, which people were panicking about earlier assuming it would go up to 2% or 4%, is actually stabilizing at 3.15% or thereabout. The Hong Kong market today had one of the strongest rallies. So, most of the markets have started recovering, they are looking better. Back home also, liquidity is looking better, it is not the same situation of panic that it was a few weeks ago.

Few more positive developments are: IBC is working, Essar is a big name but many other resolutions are happening, in a democracy such as India, things have to move at their own pace, but still, they are moving in the right direction and we are seeing positive development; Corporate earnings is a mixed bag, but there are a quite a few sectors and companies that have shown revival and most of the companies that are domestically focused are doing better and some of the leading FMCG companies have also reported very good results. Coming to our various businesses, 1st NBFC, the sector itself has been in the eye of the storm and people started talking about whether this sector will continue or the past glory is over, it has already peaked, the kind of real and mismatches they have, may be they have exposure to real estate sector, now they would not grow, they would not get any funding etc, but I just wanted to give some data before we get in to a little more discussion on this with regard to our company. Last year NBFCs accounted for 37% of incremental credit, today the situation is that private sector banks, public sector banks and NBFCs almost account for one-third each and a channel or a vehicle or engine which is serving one-third of the credit requirement of the country, you just cannot take it away unless you really want our country's growth to be jeopardized in an irreparable way. Not only that, if you really look at it, the debt-to-equity ratio of NBFC sector is around 5.7 or 5.8, these are the rating agencies' aggregate estimate, which if you compare with banks, even Basel III requirement for capital is 7% and they require another 2.5% to manage the volatility. In case of NBFC, the Tier-1 capital requirement is 10% and total capital adequacy requirement is 15%.

The important thing to note is that in the last 20 years, there are quite a few banks that were required to be merged, otherwise on their own they had solvency issues, touchwood, from 1998 till now, no NBFC really has gone bust, so the capital adequacy requirement really works very well. Many times the question raised is that it's the bank fund which NBFCs use, but from a systemic point of view, it is very good because you have two layers of capital buffer. So, when banks are lending, they do the diligence, they have their capital adequacy and then it comes to NBFC and they have their capital adequacy besides of course the advantage of last-mile, lower-cost and their specialized skills in credit collection, underwriting in certain verticals particularly the small retail loans. NBFCs do not typically fund large projects or big industrial houses and therefore the relative share in SME, the small and medium enterprises as well as the consumption loan is much higher. I think that is what the growth engine for the economy is. So, I think NBFCs are here to stay, they have an important role to play and in a panic situation we can see stock market valuation also jarred widely, but being part of the industry, being part of the running an NBFC, I feel very comfortable that people will again see that the sector is very well placed. Then about the liquidity, till now there is a trial by fire for the sector in terms of all kind of rumors, the scare and also whatever happened in mutual funds, still, touchwood, I think the industry has come out very well. On whether one can improve the liquidity profile, of course, yes, whether there can be some NBFCs that are highly levered for more exposure? That is actually possible, but as far as we are concerned, we see tremendous potential for growth in this business. Also if you notice, and you would have seen in our presentation, in the last quarter alone we added 208 branches for our NBFC business which includes majorly the large number of branches of microfinance - 135 branches, and also quite a few for our other loan products. So, we continue to invest in technology, people and infrastructure as required.

In terms of our growth focus, we have been very consistent, if you see last several quarters, we have been saying that we have to focus on retail lending and our focus is on SME small ticket lending, where our ticket price is just about Rs5lakhs, small ticket home loan, where ticket size is Rs20-22lakhs &

microfinance loan and gold loans. These are the businesses that we have to focus on, by implication or by deduction, and you can see that construction finance, real estate, LAP or loan against shares are the businesses which are growing at a slower pace or de-growing. In terms of interest margins, of course there is bit of a fall since last quarter and one can see that as the liquidity profile of liability changes, there can be some more pressure on NIM, but we are geared up to make sure that we have the right product mix and we save on our operating cost and thereby make up for it. Last quarter NIM is also impacted because quarter before last we had a securitization gain coming in. But going forward, I think there may be some impact on NIM, but we expect it can easily be made up over a period of time by product mix as well as having a tighter control on cost. In terms of liquidity, we repaid about Rs4000cr of CPs as a group. Some new CPs that we have contracted, are for three months or longer so they basically cross over December. Besides the CPs, Rs700cr of NCD which sell due for payment and all the debentures or bonds have been paid in time and in total we paid about Rs5000cr of debt of short term and long term in the month of October. In terms of liquidity, we do not want to get into granular details, but I can only assure that we are monitoring on a day to day basis, the core management team, all my senior colleagues, we are completely in control and comfortably placed with adequate margin of safety for all our businesses.

Coming to our Wealth Business, Karan is also there, he will take your questions as we'll and talk more about it. The velocity of the flow of funds, the new money is about Rs5,000cr which has been a similar number for last several quarters and that shows the fundamental robustness and stability of the business. Very interesting number to note in our presentation if you have seen that the overall asset base is of Rs1,40,000cr, we actually segregate the changes in AUM by showing new money as well as the market losses or profit separately and this we have been doing for last several quarters. The market loss on the base itself is just about Rs1,500cr in the last quarter which is just about 1% on an aggregate basis. That shows that our asset allocation with our client has been fairly prudent and there has not been excessive exposure to mid-cap or equity which probably would have resulted in larger losses and the flow of money also continues. Over a period of time, I think these are the things that we are more concerned about, that we keep getting new money and we make sure that the business remains stable and robust from a longer term fundamental perspective.

Securities Business: Although I know many people expect this business to be more volatile, if you look at the earnings then they exhibit similar trend as other businesses. In this business of course investment banking was impacted last quarter and there may be more impact in this quarter because our investment banking revenue is mostly from ECM and which depends a lot on IPOs and QIPs. At least at this point in time it looks like that many issues might have been deferred, and this quarter may be a tough one, but more importantly, the other two segments of securities business which are: retail equities and financial product distribution, and institutional business, are becoming less volatile because the dependence on foreign capital or FPIs or FIIs has reduced. We have been gearing retail investors towards mutual fund rather than direct equity and I think this trend will continue which will make this business more robust and stable from a longer term perspective.

Now coming to the corporate reorganization, the demergers are on track, most of the important approvals like RBI, SEBI etc have already been received. NCLT has convened a shareholders' meeting on 12th December. Once shareholders under the supervision of NCLT approve it, I think most of the other things are procedural which is basically submit the approved scheme to NCLT and then obviously the process of getting it listed through Exchanges. We expect this to be done in the last quarter of this financial year which is as per the schedule that we have discussed earlier.

With this, I hand over to Prabodh, who will take you through financial numbers and then we are all there for the question-answer. Thank you.

Prabodh Agrawal: Thanks, Nirmal. We are very pleased to report 29% YoY growth in our group net profit to Rs301cr for 2QFY19. Net profit after minority interest has grown by 30%YoY to Rs230cr, ROE was 16.4% and ROA was 2%. In our NBFC business, loan AUM grew 40%YoY and 8%QoQ to Rs36,373cr. Profit after tax computed as per IND AS grew by 70%YoY to Rs161cr. Our Tier-1 CAR stands at 15.5% & total CAR at 18.7%. Primary drivers of our AUM growth are small ticket home loans which grew by 59%YoY, small ticket MSME loans which grew by 113%YoY and Micro-finance loans which grew by 259%YoY. The latter two products are growing off a small base. Besides these 3 fast growing products, we also recorded good growth in Gold and CV loans. On the other hand, growth in LAP and Capital Market loans was moderate, as planned. In home loans, our focus remains primarily on small ticket loans to the salaried and self-employed section. The fastest growing segment in home loans is the affordable home segment of Swaraj Loans with average ticket size of Rs13lakhs. Swaraj Loans accounted for 22% of our home loan disbursements in Q2FY19 and 14% of closing home loan AUM. Our Swaraj product is specially designed to support the informal income segment in fulfilling their dream of owning a house. IIFL Housing Finance has been a significant player in the Pradhan Mantri Awas Yojana - Credit Link Subsidy Scheme.

Within construction & real-estate Finance, the mix continues to change towards construction finance for small ticket housing projects. As on 30th September 2018, we had over 7,300 approved housing projects, nearly up by 1.5x from 5,000 approved projects a year back. All our construction finance loans and 50% of home loans were made through these approved projects.

Retail loans including consumer loans and small business finance constitutes about 85% of our loan book. Another strong characteristic of our loan book is a large proportion of loans that are compliant with RBI's priority sector lending norms. About 50% of our home loan, 56% of LAP, 87% of CV, 42% of SME and nearly all of our MFI loans are PSL compliant. In aggregate, nearly 46% 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. The share of loan sold down currently stands at 15% of our AUM and our endeavor is to take this up to over 20% in the next few quarters. We have been selling down both PSL & NPSL loans in 6 product categories including home loan, LAP, SME, CV, gold and micro finance. In this regard, we have an ongoing relationship with several governments, private and foreign banks. Our average cost of borrowing rose by 10bps QoQ and 20bps YoY to 8.7%. Incrementally, our borrowing costs have risen by 75-100bps due to the liquidity crunch.

In a rising interest rate scenario, we are in a position to commensurately re-price our loans. 46% of our loans are on a floating rate basis. In the last four months, we have raised our home loan rate by 90-100bps, LAP, Construction Finance, CV, Gold and SME loans by 150bps and capital market loans by 200bps. Our NIM was at 6.8%, contraction of about 50bps QoQ and about 75bps YoY, primarily due to upfront gain of Rs40cr booked on direct assignment portfolio in the previous quarter. In this quarter, we did asset sales of Rs1,492cr versus Rs2,400cr in the previous quarter, so the volumes were slightly lower. The upfront gain booked in the current quarter was completely offset by reversal of gains in the previous quarter. Medium and high yielding assets currently constitute 52% of our AUM. These include micro finance loans, MSME loans, gold, CV and construction finance. The other half of our AUM consists of relatively low yielding assets including home loan, LAP and capital market loans. 90% of our AUM comprises of loans that are secured and about 10% of loans are unsecured. We believe our AUM mix is well balanced with some scope for the share of high yielding and unsecured assets to go up. We continue to add branches in our HFC, gold and micro finance businesses, and total numbers of NBFC branches have grown by 52%YoY to 1,755. Consolidated GNPAs and NNPAs recognized as per RBI's prudential norms and provisioned as per the Expected Credit Loss (ECL) method prescribed in IND AS stood at 2.2% and 1% of loan respectively. As a result of implementation of the ECL provisioning under IND AS provision coverage on Stage-III assets stood at 53% and on standard assets at 191bps. Return on assets was 1.9% and return on equity was 16.7%.

Some update on the liquidity position: We have a positive ALM mismatch across all buckets. On the asset side, our loan book has a relatively short maturity pattern with 28% of loans having maturity of <6 months and 40% of loans having maturity of <12 months. Our funding mix is well diversified including 18% from NCDs, 5% from subordinate debt, 35% from bank term loan and NHB re-finance 16% from off balance sheet borrowings & 24% from commercial paper. During the month of October, as Nirmal mentioned, we were able to contract new CPs and repay old ones. In October, we have repaid and prepaid CPs worth Rs4,725cr, also we repaid NCDs worth Rs795cr. We had liquid investments of Rs2,400cr and undrawn credit lines of Rs1,535cr as on 31st October.

On Digitization, we have continued our focus on digitization encompassing every aspect of customer loan journey. Of the total 8.18 lakhs loans disbursed in Q2FY19, 99% were on-boarded digitally. We have focused on backend process digitization through multiple innovations as well as partnerships, helping us achieve process efficiencies. With 162,000 mobile app downloads in Q2FY19 and 4.4 lakhs cumulative downloads, "IIFL Loans Mobile App" is growing steadily, fulfilling account management and servicing needs of our customers. Consequent to the change in policy regarding usage of Aadhaar, we have moved to non-Aadhaar based KYC processes across businesses.

On Analytics, we continue to drive the use of credit codes and automated decisioning across products and strengthened risk mitigation by developing and deploying behavioral score cards for purpose of providing repeat funding of existing customers. We have retrospectively deployed advanced analytics in CV business. We have tightened our credit approval thresholds in regions we anticipate greater on-boarding risk. There is continued focus on cross-sell and win-back which are analytically driven gold loan win-back generating strong volumes for both gold business as well as group-wide products. Analytics triggers are also being used by Fraud Control Unit (FCU) to eliminate fraud applications in pre-disbursal stage as well as for initiative proactive action in post-disbursal stage.

Some comments on the wealth management business. IIFL Wealth PAT computed as per IND AS was at Rs100cr. Our assets under advice management and distribution have grown 3%QoQ and 23%YoY to reach Rs1.45 trillion. IIFL Wealth raised equity capital of Rs746cr in June 2018 through a private placement to six institutional investors. Out of this amount, we had allotted shares worth Rs652cr and the same forms part of net worth as on 30th June 2018. Allotment of the balance Rs94cr worth of shares was completed in August 2018. We had 10 bankers during the quarter, taking the number of bankers to 358, to further drive the growth momentum. We now have presence in 24 locations and 9 geographies. IIFL Wealth offers a broad range of products and services to participate in a larger share of the client wallet. This includes financial product distribution, advisory, brokerage, asset management, credit solutions and estate planning. We raised net new money of Rs5,171cr in Q2FY19 versus average quarterly run rate of around Rs6,000cr last year. AIF assets have grown 53%YoY to Rs13,676cr. IIFL Wealth Finance which offers loan against securities and margin funding to high net worth clientele, grew its loan book 28%YoY and 10%QoQ to Rs6,191cr. Average lending rate for this book is around 10.5%.

Some comments on capital markets. IIFL capital markets which largely comprises of retail broking, institutional broking and investment banking businesses grew its net profit by 23%YoY. During the quarter, our average daily cash turnover was up 9%YoY to Rs1,334cr versus 19%YoY growth in the exchange cash turnover. Our average daily total turnover, including F&O was up

59% YoY to Rs21,070cr. Our NSE market share in the cash segment was around 3.7% and in total around 1.9%.

We are continuously enhancing our offerings on digital and mobile platform for retail customers in our broking business. Our mobile trading app, "IIFL Markets" has had over 2.1mn downloads. Presently, about 44% of our retail broking customer trade through the mobile app. We completed 4 transactions in investment banking.

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

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.

Sunil Tirumalai: This is Sunil Tirumalai from Credit Suisse. I have three questions: Firstly, continuing on the discussion on the liquidity situation, so we understand going ahead into November, you have a fairly large amount of maturity redemptions around Rs7000-8000cr coming. Just wanted to understand, how are you approaching it, is it through bank lines, what additional cost do we see over and above this 75-100bps that you mentioned in your opening remarks?

Nirmal Jain: We do not have Rs7,500cr maturing in November. If you are talking about total CPs it will be a different thing but we have got Rs4,000cr liquidity with us, of which is Rs2500cr of cash and Rs1500cr of undrawn bank line. Besides that, as we have mentioned in our presentation, Rs2000cr of the securitization, which is at a very advanced stage, will conclude in this week itself. So, that meets our entire requirement for the month of November.

Sunil Tirumalai: What outlook would you give for your loan growth overall?

Nirmal Jain: Our focus segments will continue, maybe last month everybody was in a state of uncertainty, but I think its stabilizing very soon. If you look at maybe this quarter or the next, then our core business e.g. gold loan or small ticket home loan or SME loans should be back to normal. Except for one caveat, which is, if the interest rates go up, then that can impact the demand itself which is difficult to figure out at this point in time whether interest would go up in a permanent way or will stabilize again back to the normal level. If we ignore that for a moment, then otherwise the real economy is doing well and we do not see any let down in growth.

Sunil Tirumalai: On your GNPA number, there seems to be a fairly sharp rise, just on absolute rupee crore terms, it seems to be like 18-20% jump on QoQ basis. What is happening there? What is the outlook on this? Is it something that should be worried about?

Nirmal Jain: There are two things: GNPA real estate and CVs. In commercial vehicles what happens, we recognize on a 90-day basis. Many a time's truck drivers do not have a culture in terms of availability also and even one installment miss becomes basically GNPA. That is one problem that we are dealing and grappling with that how do we get this under control. Other than that, the real estate sector has lumpy loans. So, we also give GNPA of each product category separately. So, if you really notice, then other than these two, most other businesses have remained stable, there is not much change.

Sunil Tirumalai: Can you give some color on the real estate book as to how many accounts are under problem and which geographies?

Nirmal Jain: We have exposure all over the country but most of the accounts that we are talking about, we have adequate collateral which is clean and we can recover our money. So, our book is fairly diversified, it is not really focused on one geography and in terms of borrower segment also, it is not really a concentrated exposure. But I think the sector has been under a bit of a stress, more from the cash flow and not from the point of view of value or the quality of collateral. So, over a period of time, we are confident that we will recover all the money.

Sunil Tirumalai: The real estate sector stress that you mentioned is that something at an industry level you would be worried about in terms of liquidity for the builders and probably on home loans? Some people may be going slow, maybe that is impacting some home sales, etc., some color on that would be helpful.

Nirmal Jain: The major issue will be in the very high priced luxury segment of Mumbai, maybe followed by some other areas in Gurgaon, if they are premium properties. But as far as affordable is concerned, the small ticket home loans or the builders are building either in the suburbs of large cities or small cities, I think there things have been stable and moving at least till now. In terms of the industry, our exposure is limited; we do not have exposure to the whole sector, as out of our Rs36,000cr AUM, the builder/developer segment is not even 10%. So, I really can't talk about the industry but, I am hearing what you hear, the stress in high priced, high value segment because, sales are slow; therefore cash flow is slow and that is causing a concern.

Sunil Tirumalai: The last question is on the wealth management piece to Karan. Having had a quarter or more to discuss with various AMCs on the SEBI changes on upfront commission and tier-1, etc., how is it now playing out when we see that your yields on slide #25 is down sharply QoQ, is that an effect of that, how do we see this going into the long-term?

Karan Bhagat: From an AMC side, there are not too many changes from what we discussed last quarter. I think the broad impact on the retro session and commissions has not really changed. From a yield perspective, I think on the mutual fund side, as we go forward, there will be a greater migration towards direct plans as compared to broker plans. The mutual fund part of the business is going to transition to an advisory business over the next 12-18-months, where plans will essentially, as I have said earlier, be put in a mix between direct plan and broker plan and slowly the market will move towards an advisory flow. The small variations or the little changes in yield are a function, a little bit more of asset class investments, for example, in the last quarter, and investments are more fixed income biased as compared to equity. That causes a little bit of variation in yields over QoQ basis as opposed to any large change in mutual fund commissions.

Sunil Tirumalai: So, the 65bps yield that we have now, where do you see that settle given what you said over the next 12-to-18-months? What are the trends?

Karan Bhagat: I think, retentions will continue to be in the region of round about 75-80bps, which will be a function of combination of fee-based income as well as fund-based income. The fee-based income on a consolidated basis will hover around 55-60bps and the fund-based income will add another 15-20bps going forward.

Moderator: Thank you. We will take the next question from the line of Anita Rangan from HSBC. Please go ahead.

Anita Rangan: I had a question on Slide #17 and Slide #18. In Slide #17, you mentioned that your cumulative inflow for six months is about 15,484 and in the next slide of loan maturity, on a zero to six months are about 8,729. So, I just want to understand what is the difference between these two inflows here in the liquidity flow?

Nirmal Jain: Slide #18 is based on historical past data, which is how our loans mature and what is the loan book. But in reality it is a going concern, so we will also have a flow of new disbursals as well as corrections. So, which amount you are trying to reconcile?

Anita Rangan: The inflow amount in the 6 months bucket like cumulative inflow, this is 15,000 versus like 8,700…

Nirmal Jain: The Rs15,000cr in six months cumulative bucket versus Rs8000cr. So, this 8000 is just the repayment of loan but the Rs15,000cr is including the new loans and the opening liquidity which is around Rs4,000cr.

Anita Rangan: 2nd question is in this slide #18, you mentioned like zero to six months bucket is about Rs8,700cr. Does that include any prepayments in the business here?

Nirmal Jain: It will be based on the historical trend. So, what we have done is that we take the past data of the foreclosures and prepayment and also the normal payments and then based on that we work out percentages for each product category and there also we keep updating as the trends change.

Anita Rangan: Another thing also, I wanted to understand this Rs4,700cr of CPs which you have repaid, was the entire repayment or there has been like some rollovers also and you are able to prospectively get some rollovers in the market?

Nirmal Jain: There have been some rollovers as well as some pre-payments. I think up to 9th November, whatever had been mentioned, we have already prepaid. Many of the mutual funds are reluctant to take the money back early but when there is liquidity then it is a bit of negative carry. That comprises both, the normal repayments as well as prepayments. Some of that have been rolled over as well.

Anita Rangan: Also, when you talk about close to Rs5,000cr of liquidity in terms of unused bank lines and securitization, everything put together, this is at a group level or it is for individual?

Nirmal Jain: This is only at IIFL finance level. I am talking about Rs4,000cr liquidity as at 31st October and Rs5,000cr that you are referring to is at 30th September, both the numbers are there in the presentation. Rs2,500cr will be the cash and Rs1500cr will be unused lines, this is over and above what we have in IIFL Wealth Finance.

Anita Rangan: On the real estate side, your average ticket size is about Rs11cr. So, just want to understand what would be the highest on the peak side, what kind of lenders you would have lent to and like can you give some color on the geographies and kind of apartments these developers are selling?

Nirmal Jain: Rs11cr is the average size, but on the higher side it can go up to Rs150-200cr also. So, this is diversified and spread all over the country. So, most of it is to the affordable segment where the apartments are of lower value.

Anita Rangan: Are you seeing any kind of stress or anything in any of the larger ticket size developers?

Nirmal Jain: Yes, so there are one or two cases in the last quarter that have gone into the NPA bucket, we are working on that, but as I said that in all cases we have adequate collateral which has a value. In case we have to recover then we can liquidate the collateral or maybe force-sell the collateral. We are fully covered. But there is liquidity stress in the system that impacted the real estate sector more than anything else.

Moderator: Thank you. We will take the next question from the line of Shiva Kumar from Unifi Capital. Please go ahead.

Shiva Kumar: Sir, can you revisit the AUM growth target and the margin trajectory from the NBFC point of view?

Nirmal Jain: There are two parameters; one is liquidity and the other is interest rate. So, unless we are fixed on interest rate, it is very difficult to rework the growth numbers because that is something that will impact home loan business more which is very significant. Almost half of our business is coming from mortgages. There, it is relatively interest-sensitive because people will defer their home buying, if the interest rate goes double-digit, there is lot of resistance. So, we will have to wait and watch how the November month goes in terms of liquidity and how the whole sector and industry recovers from this.

Shiva Kumar: Sir, how is the mutual fund industry behaving post September 20th, are the lines with mutual funds open or they are still figuring out as to how they should go forward?

Nirmal Jain: There are two types of mutual funds. One of them is still figuring out and some of them have started doing business back in a slightly higher yield. What we are seeing is that the AUM is getting concentrated more in the larger mutual funds. So, if you really look at AUM, then some of the larger mutual funds maybe at a level higher than what they were prior with the prices, some smaller funds are getting decimated completely.

Shiva Kumar: Coming to the Wealth Finance business, given the volatility that we are seeing in the market, how has been your risk management practices in that particular segment because we read from the media that in the case of Ashapura you had to actually take ownership of the shares which were given as collateral. So, have you seen an increase in such cases and have you taken some kind of provision for any losses in such cases?

Nirmal Jain: You have two different questions: So, one is about IIFL Wealth Finance and the other is about Ashapura. So, let them be taken separately. Maybe I will ask Karan to talk about IIFL Wealth Finance in a minute but before that I will just talk about Ashapura. In case of Ashapura, we had exposure through NBFC as well as through margin funding. Now, what happened to this company was very unexpected and unusual but the company had a business which had a good track record and a brand and there are people who are willing to take over the company also. So, we have not taken over the shares but what we did is that there was a pledge created on that because of the large amount, the pledge got reported and being illiquid are a much larger cover. So, it appears to be very significant part of the company. But I think the family and key people in the company are working on a transition of ownership along with management. So, I personally feel that we would not have any losses there. As far as we are concerned, we are fairly well covered, we have almost about 32%-33% of the company's equity for cover and our exposure is about Rs40cr from both these put together. So, that is one part of it. The 2nd part of the question which you asked earlier is that how is the risk management, are there any stresses or losses in IIFL Wealth Finance? Karan, do you want to take that?

Karan Bhagat: So, on the Wealth Finance side, our loan book is fairly conservative, we work on 50% margin and typically most of the book is funded back to our wealth clients against their portfolios. In India like we see clients do not typically borrow to invest, they borrow against the investment portfolios for temporary liquidity needs. We have been doing this business under the aegis of wealth finance for the last 2.5-3-years and before that we were kind of had a compartment within IIFL finance itself. Over the last 10-years at least, we have not had a situation even once since 2008 where we have had to incur a single rupee of loss as of now. Even in the current stress over the last 30-45 days we have not really encountered a situation where even on a marginal case of not being able to recover money. So, there is really no need for looking at any kind of provisions on our loan against shares book on the asset wealth finance book.

Shiva Kumar: Karan, just staying put with the wealth business, what will be the mutual fund in the overall AUM and what is your ballpark effect on the yield that will get to see once the SEBI rules on trade commission are implemented?

Karan Bhagat: So, our ballpark AUM of mutual funds would be in the region of round about Rs50,000cr, which is broken up into two segments: one is mutual funds, which should go under the broker plan and second mutual funds, should go under the direct plan. There has been a function, what is called an RIA which is the Registered Investment Advisor. Under the broker plan, it will be in the region of Rs28,000-30,000cr, RIA would be another Rs20,000-22,000cr. Typically on the RIA, we do not get any commissions as we speak now. We work on advisory fee basis from the client. On the Rs28,000cr, our retro session on a trial basis because we discontinued upfront for more than a year on mutual funds, in the region of about Rs135-140cr a year which is round about Rs35cr a quarter which makes up about 14-15% of our overall net revenues. This may come down by round about 5-6%. So, effectively 14% of our revenues will be down by round about 5%. So, there has been impact of round about 0.8% of our revenues because of the SEBI change in TER commission laws.

Shiva Kumar: Getting back to the holding company, we have been reading in the media about this commodity license issue which has been tackled by SEBI and also that fit and proper clauses is under consideration. Would you like to comment as to how severe is the issue there. It seems there was a meeting between SEBI and the brokers about two weeks back, so what is the consensus there?

Nirmal Jain: This is my personal view, but nobody knows how the ultimate verdict will come. I do not see any serious or significant cause to worry there. Now this is a case which is almost 5-6 years old, we have not done any proprietary trading, we never had any funding exposure but this notice was given to five top brokers and now I think SEBI has issued notices to 281 brokers. So, it is a systemic issue because everybody relies on NSEL and there are so many brokers which did more or less similar thing. Of course, SEBI show-cause notice was there and there was a hearing. But the way I think this is getting reported in media and obviously I cannot really know or tell you who's behind that but somebody is trying to put it in a very exaggerated manner or a very one sided manner which gives a wrong picture to the people who are reading. But the fact of the matter is that there was EOW investigation, based on that SEBI picked it up. So, being a regulator, they have issued show-cause notices and they wanted to investigate the matter, so they basically called the top-5 brokers, they did hearings, I think one or two rounds of hearing or all the hearings are over. Now the next process is SEBI has asked for written submission if any, which are called additional written submissions beyond what you have given to show-cause notice and based on that they, will pronounce the final verdict. If brokers are not happy, they can go to SAT or they can go to higher court also but interesting thing is that now this investigation has started, it includes almost about 300 brokers, so whatever will happen has to happen to all of them and not to just one or two brokers. Incidentally, one more thing I will tell you, this was done through Commodities Company, a subsidiary company, which is being investigated. The commodities business has shifted to the step-up parent company which is Securities Company under the unified license.

Moderator: Thank you. We will take the next question from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Just going back to slide #17, I was just wondering how one should be reading this, so let us look at the six months bucket, when you say cumulative outflow of Rs12,339cr, does this mean that these are the redemptions of your borrowings or are these the redemptions of your borrowings plus the disbursements that you need to make?

Nirmal Jain: This is a static liquidity, so these are the redemptions of borrowings and the committed payout.

Nischint Chawathe: So, whatever is the disbursement that you would do in 6 months, would be over and above this?

Nirmal Jain: And the collections also.

Nischint Chawathe: On the NII part, you did mention that there was some assignment income booked in the 1st quarter of this year and you did some assignment in the 2nd quarter as well, but there was effectively no assignment income booked because of some write-back, I did not kind of quite follow that, this is something….?

Nirmal Jain: What has happened is that new IND AS accounting standards have come to effect from this financial year and we are also just trying to understand and get ourselves stabilized in terms of how the accounting will take place. So, what happened that, when the last year accounts were re-cast based on those our provisions were created for every quarter separately. This year 1st quarter we had an assignment on which Rs40cr of income was there upfront which is booked. But in hindsight we realized that maybe this was a little aggressive booking on the income because there are some prepayments that have happened and the actual accrual may vary from quarter-to-quarter, eventually it may be little lesser than this. Out of that there was some reversal this quarter and whatever new assignments we had done, so that is what Prabodh was mentioning that out of Rs40cr we had a reversal this quarter of almost about Rs14cr which more or less matches with the income on the new assignment. So, that is why you see QoQ a fall in our IND AS accounting profit for IIFL Finance.

Nischint Chawathe: I believe when you are doing the assignment income you would normally be accounting for prepayments, right?

Nirmal Jain: What happens in assignment income is when you are doing assignment income without recourse, means the risk is fully transferred to the buyer of the asset, then you can take the full income upfront, but what you have to take care is that you have to really estimate how the portfolio will behave in terms of prepayments, foreclosure and that answer will become very critical in taking the income going forward.

Nischint Chawathe: So, I guess last quarter you have not assumed the prepayments and now you have re-casted the portfolio to assume..?

Nirmal Jain: What we had assumed and what actually was happening was little different, then we have again just tried to balance it properly.

Nischint Chawathe: On the fund mobilization side on the IIFL Wealth business, how should you really be thinking about it in terms of the AUA growth going forward?

Karan Bhagat: As we have guided earlier I think about 20% growth in corpus YoY approximately with the (+/-5%) variation is what we should be looking at. So, effectively this year Rs20,000cr-25,000cr of net asset flow into the business is essentially the guidance number which effectively translates to about Rs5000cr-6000cr of corpus on QoQ basis, stripped out for the mark-to-market impact on the portfolio.

Nirmal Jain: Mark-to-market can be either way.

Nischint Chawathe: Incrementally, if you look at the next six months or possibly looking forward to the next year, which asset classes or which kind of products you think will drive this mobilization?

Karan Bhagat: I think from a portfolio allocation perspective, it is kind of a diversified portfolio with a broader mix between fixed income and equity. As we stand today nearly 54%-55% of the assets would be in equity at equity constituents, 45%-odd would be broken up into fixed income. Within fixed income, most of it would be in AA+ to AAA kind of categories through mutual funds or direct holdings. On the equity side, again, it will be a combination on mutual funds alternative investment funds PMSs and little bit of direct equity. So, it is a fairly diversified portfolio. I do not see any change in it. I think clients would continue to spread their allocation between all these instruments. On an asset allocation basis, I think if markets continue the way they have been for the last 30-45 days you might see roundabout a 5% shift from equity to debt, but that is about it. So, I expect it to be in the region of 45% to 60% in fixed income and 45%-55% in equity going forward. From an instrument perspective, not many radical changes, obviously, on the high net worth side alternates has an alternate investment funds, have a bigger share of new flows as compared to equity funds. So, that is the only kind of new trend we have seen over the last 12-18 months, but barring that really it is the same old instruments.

Nischint Chawathe: Just one last thing on the AIF side or on the PMS side, do you really see the risk of realizations going down given the fact that mutual fund TERs have come down as well?

Karan Bhagat: To be fair, alternate investment funds and PMSs fees have been much more competitive than mutual funds for the larger ticket sizes. So, contrary to typical perception for clients who put in Rs5cr-Rs10cr cheque into alternative investment funds and PMSs, unlike a mutual fund you have a tiered fee share of management fee structure. So, some other client is putting in Rs5cr-Rs10cr, even today before the reduction of TER of mutual funds, he was able to get a management fee share class, which was nearly 50-70bps cheaper than a regular share class in mutual funds and possibly 25bps cheaper to what he could get in a direct plan in a mutual fund. So, PMS and AIF in that sense have already been fairly competitive. In case direct plan fees in mutual funds come down even more, right now on an average direct plans 125bps. More or less most large clients cutting in let us say Rs5cr cheque in either PMS or AIF would already be getting that fee structure or possibly even lower. In case direct plan fee structures come even lower on the mutual funds, then we may see some 25bps reduction in fees in PMS or AIF, but otherwise I really do not see it, because that change has happened practically over the last two years for all large clients.

Moderator: The next question is from the line of Keyur Shah from Emkay Global. Please go ahead.

Keyur Shah: You mentioned that you see there is some stress in high price in premium segment developer inventory due to lower off take, so do you see that continuing for some time or how do you think it is shaping up?

Nirmal Jain: I think it will continue for some time. So, best case scenario in my opinion is, time corrections with the prices remain static where value of interest of money becomes cheaper. So, when I say high priced segment, I am talking about the Parel, Worli area, lot of constructions that has happened there, it can continue for some time.

Keyur Shah: Do you see any prices going down due to this situation?

Nirmal Jain: Already coming down. So, if you have money you sit, go with the cheque, the price is yours. So, today if you really want to buy a house or premium apartment in Bombay premium areas at the heart of the city then as I said Worli, Parel or may be 2kms radius from our office in Parel, if you have a cheque, then you can ask your price and get a discount.

Moderator: Thank you. The next question is from the line of Atul Mehra from Motilal Oswal Asset Management. Please go ahead.

Atul Mehra: Just one clarification on this Ashapura incident. Does this trigger an open offer for us in any form, is there is regulatory clarification on that?

Nirmal Jain: It does not because it is just a pledge; we have not done anything beyond that.

Atul Mehra: The point is that if we were to acquire the shares and resell it to anybody who is interested in that?

Nirmal Jain: We will not acquire the shares, we will sell it in the market only, and we will never acquire the shares.

Atul Mehra: Secondly, on wealth management, what is the mix of equity in net new money this quarter? And on the fixed income side, that we would have raised the money. Is it coming in liquid instruments which are like very low yield or is it coming in any other structures we would have in fixed income?

Karan Bhagat: I am sorry, I will not have an exact breakup of the equity in the net new money, but in the gross flows fixed income is a large portion this quarter, 70% would be the breakup of fixed income in the gross flows. Net new money I can come back. My quick number would be exactly the inverse of that; it would be round about 30%. Approximately, gross flows 65% to 70% has found its way into fixed income and related instruments, 30%-odd in equity on the gross flow side. Net flow breakup of corpus, I do not have, I will come back.

Atul Mehra: Just one more thing on the same question, in terms of fixed income, is money coming on extremely low yield liquid kind of instruments or is it any other structures that you may have?

Karan Bhagat: No, it has been a combination, so most of the money in the last 30-days specifically has come into fixed maturity plans. So, fixed maturity plans obviously have a lot flavor, but typically a three or three-and-a-half years SDL kind of FMPs. So, typically low risk FMPs is something which has got in a lot of attraction. We also closed large private equity fund which was essentially a private equity fund of professional entrepreneur, so really where the fund owns a majority of the business, so that fund we closed around Rs1000-odd crores, so large part of that collection happened in the last quarter. That also in a sense is immune to market levels and the fund is more or less sitting in cash right now because we enter the business pretty much at face value.

Moderator: Thank you. The next question is from the line of Dipan Mehta from Elixir Equities. Please go ahead.

Dipan Mehta: My question relates to the operating expenses in IIFL Finance and those are consistently going up QoQ, YoY at a much-much faster pace than the net interest income or even the total income, which is the reason, but resultant is that flat kind of pre-provisioning profit. So, what is the main reason for such sharp increase in the operating expense? I understand you are opening branches and so on and so forth, but there has to be some synchronization with the net interest income increases as well.

Nirmal Jain: What you are saying is a very valid question, but number of branches and number of people have grown up very significantly. So, if you see number of employees almost up 85% YOY because the microfinance, the new business that we have taken over, we are also building strength in our housing finance and gold loan, but going ahead it should taper off, the pace of growth will slow down for sure, but last year if you see the number of people that we have added has been very-very large number. So, primary reason is branches and people actually and microfinance, gold and housing finance these are the businesses where we added a large number of people & branches.

Dipan Mehta: By what point of time do you think Q3, Q4…?

Nirmal Jain: We have already started the process. As I said the incremental growth will be slower as compared to what has been in the past.

Dipan Mehta: Second question relates to what the CFO said about the interest write-back, I am not very clear, so, is it that for Q2 we would have Rs40cr more of net interest income, what exactly was the effect on securitization?

Nirmal Jain: In Q1, there was securitization profit of Rs40cr which is not there in Q2.

Dipan Mehta: Then assuming that is the case, then the net interest income growth is hardly 20% for Q2 over Q2FY18, so that I mean is a sharp slowdown from what we have seen in earlier quarter?

Nirmal Jain: That is what I am saying, Rs40cr get accounted as interest slipping in the interest income. The securitization gain that comes gets clubbed with interest income. So, that is why you are seeing interest income not growing.

Moderator: The next question is from the line of Jehan Bhada from Nirmal Bang. Please go ahead.

Jehan Bhada: Broadly, the NBFC and the consolidated ROE is at a similar number. So, my question is on the wealth side, ROE again over there should be at similar number. What is the outlook going forward; can the number of ROE go up to 25-odd% and what are the levers that will push that number higher?

Nirmal Jain: In wealth, we raised capital last quarter and that is what has depressed ROE of wealth and thereby for the group. So, as we start using this capital more effectively over the next few quarters, then we will see our ROE moving up to the target level.

Jehan Bhada: Do you have any targets in mind as to what can be the steady state ROE for the wealth business?

Karan Bhagat: Steady state ROE for the wealth business should be around the 25%-27% region. Obviously, we had an acquisition in mind over the last three to four months which was the part of the reason for raising a bit of the capital, and secondly, obviously we wanted to, even in the wealth finance side, reduce our dependence a bit on CPs. So, that essentially led us to raise a bit of capital in the second quarter of the calendar year and essentially, as Nirmal pointed out, over the next 12-odd-months as we chart out on our next growth path. The third utilization of the capital is essentially to act as a sponsor for alternative investment funds, that business is growing fast, we have nearly got $3 billion, Rs20,000cr of capital commitment in that business. We end up putting 1%-1.5% of sponsored money as our own capital contribution. So, these three things essentially are where the capital will get utilized and as the business scales up, the ROE should move up. If you see over the last three to four years consistently we have been around the early 20s in terms of ROEs. So, it is just a quarter since we raised the money effectively. So, over the next 12-18 months we should be closer back to the 20%-25% ROE number.

Moderator: The next question is from the line of Megha Hariramani from Pi Square Investments. Please go ahead.

Megha Hariramani: Most of my questions have been answered, just on the same IIFL finance consolidated numbers; the loan loss provisioning has come down, any substantial reason for that?

Nirmal Jain: Yes, because the last year provisioning was abnormally higher for the new accounting IND AS in which we have to consider expected credit loss on each and every item. So, relatively it is appearing low because last year is extraordinarily high.

Megha Hariramani: Lastly, on the expected growth going forward, how do we see our AUM and the net interest income growing going forward?

Nirmal Jain: Historically, we have given a guidance of 20%-25%. So, I do not see any reason to change, but of course we have seen very extraordinary things happening in the liquidity for the sector as well as one does not know there is uncertainty about how interest rate trajectory will be from here on. So, at this point in time there is no change and my personal view is that the sector will continue to do well and we will grow at that pace only, which is 20%-25% on the top line and if you can manage your business efficiently and improve the margins, then 25%-30% on the bottom line.

Megha Hariramani: On the IIFL wealth consolidated results in the footnote, you have mentioned that in Q2 FY19 we had a lower weight-age of offshore subsidiaries in the PPT. So, is it like the offshore subsidiaries are also slowing down for a particular reason?

Nirmal Jain: This is about the tax I think you are mentioning because the tax incidence is very high in Q2, because we have provided for dividend distribution tax on the dividend received from our overseas subsidiary.

Karan Bhagat: There are three basic impacts because of the tax calculation: One, we have done a dividend out from our offshore subsidiary to India, so there is an incremental 15% impact on the dividend, it obviously helps us save on the cash flow of the dividend distribution tax. Second, our NBFC business was taxable at 25% last year because of the business we acquired last to last year, therefore the revenue was less than Rs250cr, so that business is back to 34% in terms of tax and third is like you are putting it rightly the offshore business contribution to profit is not in the same percentage terms as it was over the last two years. So, it is not to say that it is not growing the proportionate growth in the domestic business is much larger than the offshore business which is having a small impact on the tax rate, but the larger impact on the tax rate is on account of the dividend distribution tax and the NBFC moving from 25% to 34%.

Nirmal Jain: This dividend distribution tax can be completely offset against the Rs5/share dividend that wealth will pay, because this is a wealth subsidiary, but if you see the numbers on YoY basis, then the tax provision has gone up significantly because of that.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from Motilal Oswal Securities. Please go ahead.

Shubhranshu Mishra: My question is around your construction book that you have. Can you give us some color on it, what kind of names we have, how many SPVs we have, and what kind of geographic domicile?

Nirmal Jain: I cannot give you details specifically; it is spread out, if you really look at our book, when I say Rs11cr average ticket size in a large number of cases. About the geographic domicile, I do not think it is fair to disclose the names unless there is a reason for that.

Shubhranshu Mishra: What percentage of your book has exclusive charge and what percentage would be on pari passu?

Nirmal Jain: Almost our entire book is exclusive; our primary charge has to be the first charge and exclusive charge. All the collateral that we have is by our internal policy, there has to be exception for pari passu but almost entirely or predominant part of our collateral is exclusive and not pari passu.

Shubhranshu Mishra: If you can just give us what percentage of the book are MCR, MMR, Bangalore, and Pune and so on and so forth?

Nirmal Jain: I do not have that breakup with me right now, but it is fairly spread out as I said.

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

Nirmal Jain: Thank you so much and if you have any more questions, please feel free to write to us and I also take this opportunity to wish you and your family and loved ones a very, very happy Diwali and a very prosperous new Samvat year as well. Thank you so much.

Moderator: Thank you very much, sir. 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.