IIFL Holdings Limited

Consolidated Financial Results – Q2FY17

Conference Call Transcript

October 27, 2016

MANAGEMENT:

MR. NIRMAL JAIN – GROUP CHAIRMAN, IIFL HOLDINGS LIMITED

MR. R. VENKATARAMAN – MANAGING DIRECTOR, IIFL HOLDINGS LIMITED

MR. PRABODH AGRAWAL – GROUP CFO, IIFL HOLDINGS LIMITED

MS. DHANASHRI RANE – INVESTOR RELATIONS, IIFL HOLDINGS LIMITED

Moderator: Ladies and gentlemen good day and welcome to the Conference Call to discuss the Consolidated Financial Results of IIFL Holdings Limited for the quarter and a half year ended September 30th 2016. 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. I now hand the conference over to Mr. Venkataraman – Managing Director, IIFL Holdings Limited. Thank you and over to you sir.

R. Venkataraman: Thank you and good afternoon. On behalf of team IIFL, I thank all of you for joining us on this call. I am accompanied by Mr. Nirmal Jain – our Group Chairman and Mr. Prabodh Agrawal – Group CFO, IIFL Holdings Limited and Ms. Dhanashri Rane who looks after our Investor Relations.

As you are aware, we are a diversified financial services company with multiple businesses carried out in various subsidiaries. In today's call we would be referring to our consolidated numbers unless otherwise specifically stated as they provide a true and fair representation of our performance. Further any of us may make some forward looking statements based on management's current expectations during the call. However, actual results may vary significantly therefore the accuracy or completeness of these expectations cannot be guaranteed.

I will now handover to our Chairman, Mr. Nirmal Jain to outline the business strategy and the way ahead.

Nirmal Jain: Good afternoon and thanks Venkat. For the first time in our analyst presentation, we have articulated our goals for FY20 and outlined our strategy to achieve the same over a period of four years - from FY16 to FY20. Let me elaborate a bit on that.

Keeping our goal simple, we capture them in 3 Ds - Doubling, Durability and De-risking. Refer to the slide no. 25; I'll talk about each of them. The first D - Doubling refers to our goal of doubling the net income by FY20 and this will be at margin improvement and therefore our bottom line target is to grow a 2.5 times post minority stake. As you would be aware in the last 6-7 months or maybe in less than a year's time, we have raised close to INR 2,000 crores from General Atlantic and CDC in two of our subsidiaries. As we put this capital to work, our pre-minority or our profit before minority should grow faster maybe closer to 3 times over this time period. The second D refers to Durability of earnings; importantly for us, we would like our earnings to be sustainable and as less volatile as possible to external factors, to economic and capital market cycles. In our third goal, we refer to is De-risking the entire business model that is, we would like to insulate ourselves as much as possible and as much as we can against all the risks that we can think of and we know. And they vary and they range from financial risks, reputational risks to risk of concentration of clients or to risk concentration in a particular geographical area as well as ranges to include technology, digitization plus, threat from competition and new players in the digital world.

Now let me talk about our strategy to achieve each of these goals. Our first goal, doubling of our revenue target or income target is not very aggressive but our focus is on bottom line and profitable growth. The dominant part of our business today is NBFC or retail lending and we have raised capital for growth which should sustain us for next 3 to 4 years very easily. Further, CRISIL upgraded our rating recently and we expect other agencies to follow suit very soon. With equity capital infusion as well as credit-rating improvement, we would expect our relative interest cost to fall. While we also expect market interest rates to fall, what is more important for us is that, we become relatively more competitive and with fall in interest rates, we should be able to maintain our NIM. This is despite our target to improve our asset mix with increasing focus on home loans which can result a slight tapering off of our weighted average yield or interest yield on all the assets. But what is more significant is that we target major savings in our operating cost and that we combine the impact of increasing volumes, scale economies from there on and as well as from our digitization drive. We continue to have cost rationalization programs all across. But end-to-end process digitization will result in significant savings.

In our wealth business, we have been funded for growth and continue to invest in talent and technology. We continue to hire best of the people from the industry and I think that is our mantra for growth in wealth business. In capital market related business, which is the third key business group that we have, we have substantially downside businesses like insurance distribution where we found that it was not viable to sustain profitable growth. And in the equity broking, we are investing in mobile and online trading platform on one hand and maintaining our research edge on the other end.

Our second goal of durability of earnings is lot more important as well as subtle. Our objective is to build a business model where earning momentum can sustain well beyond FY20. So we would like to have a moat in each of our business that we operate in, which is unassailable. And I will take up the businesses one by one. Within the NBFC business, our mantra is retail lending and digital delivery. We have unique advantage; amongst non-banks we are probably one of the most widely networked NBFCs with our presence over 900 towns and cities through our branches. And our proximity to customers, our brand in this local areas and our understanding of customers give us the unique advantage to tap the growth in smaller towns or real India.

Significant changes in technology for digitization and enabling regulatory changes as well as our pioneering initiatives in these areas will help us in digitizing our operations. Our end goal is to make our operations completely automated and we shall move towards it progressively. In last one year alone, our retail assets with the percentage of total assets have gone up from 69% to 83%.

In our wealth business, our strategy to make our earnings durable is to focus on steadily increasing advisory income and asset management fee and reduce our dependence on transactional and distribution income and we are on right track.

On capital market, we are trying to focus more long-term investors and are trying to reduce our dependence on intraday traders as well on high-volume but low yield derivative trades. Our relative share in cash market is higher than derivatives and we have very insignificant presence in propriety trading or algo trading as such.

For de-risking, all our businesses, we are focusing on diversifying our asset mix. In NBFC business, we are trying to make sure that we are not geographically concentrated for any of our businesses. We are investing enormous resources in technology, security, and digitization as well as building a robust risk management framework to ensure that all types of risks are monitored and there are early warning signals. The framework is evaluated periodically and further reviewed and strengthened. With this, I will hand over to Prabodh who is our Group CFO and will take you through the details of financial numbers and after that, we can have question and answer session. Thank you.

Prabodh Agrawal: Good afternoon everybody, thank you Nirmal. We are very pleased to report a 39% YOY growth in our group net profits to INR 207 crores. Our net-worth has reached INR 4,172 crores having nearly doubled in the last 2.5 years. ROE was 20.9% and ROA was 2.9%, the highest level in recent years. All the three segments of the company that is NBFC, Wealth and Capital market contributed to this strong growth.

In our NBFC business, loan AUM grew 22% YOY to INR 20,474 crores, net profits grew by 25% YOY to INR 102 crores. CDC's INR 1,000 crores capital infusion happened in the last week of September. We are now well-capitalized for the next 3 to 4 years of growth with Tier I CAR of 19.7%, up from 12.8% in the previous quarter. NBFC's ROE of 18.6% and ROA of 2% are healthy and steadily improving. While aiming for higher volume growth, we are also striving for superior loan mix. In the last two years, the share of relatively risky loans like gold loans, capital market and construction finance has reduced, at the same time, the share of low-risk retail home loans has increased. Going forward, key loan growth drivers will be home loans including affordable housing loans, CV loans and small ticket SME loans. 80% of our LAP is on the income assessment basis or cash flow backed. Also, 80% of our LAP is backed by collateral of residential property. We are in the process of getting an external rating agency to review and validate our LAP pool and our processes. This should be in place in the next two quarters. Moreover, we are very selective in growing our LAP book; our retail mortgage product is driven by progressively higher contribution from small ticket home loans. Presently, 65% of our incremental retail disbursement is towards home loan and only 35% towards LAP. Retail loans as Nirmal mentioned constitute 83% of our loan book. Our loan book is of small ticket size and primarily focused on the lower middle class segment. Another focus of our retail loans is that nearly 25% to 30% of our loans are PSL compliant which we can sell down. Currently, the securitized book stands at 10% of our AUM. We aim to take the securitized book up to 15% to 20% of our AUM over the next 12 months through higher sell-downs in mortgage retail, CV and SME loans.

Our average cost of borrowing declined from 10% in Q1FY17 to 9.6% in Q2FY17. Incrementally, we are now borrowing at 8.8%. Going forward we will also benefit from the ratings upgrade by CRISIL to AA/Stable which happened in end of August 2016. Our NIM expanded by 20 basis points to 6.3%; the NIM which was dropping for the last five quarters due to change in asset mix towards lower yielding loans is expected to stabilize and actually improve on the back of stable asset mix, falling funding cost and large capital infusion. Cost to income ratio has declined by over 300 basis points in the last two quarters to 40.6%. Similarly, the OPEX to average asset ratio is also on the decline. Operating cost growth is moderate and lower than our income growth on the back of branch rationalization, adoption of e-surveillance for our gold loan branches, improving productivity through digitization and greater cost focus. Operating cost ratios can be brought down further through greater digitization and better economies of scale in two key products. Further, we have in place the requisite infrastructure including branches, sales, credit and risk teams and support functions. We should be able to grow our loan book significantly from the current level without requiring significant addition to this infrastructure.

Technology is a strategic enabler for our cost optimization and process innovation. There has been continuous progress on the digitization front with increasing adoption of digital processes and analytics to improve credit scoring bring down our OPEX, lower customer attrition and increase cross-sell. We have recently launched tab based sourcing for small ticket SME loans as well as digital personal loans for the salaried segment. Gold loan business is already on tab with all our branches being migrated to tab based models. During the quarter, our gold loan digital transformation project was chosen as the best Top 20 project in the 5th BFSI Innovation Technology Summit 2016 and won the Digital Innovation Champion award at CIO Crown 2016 organized by Sify Technologies.

Our diversified loan book enables us to grow in a de-risked manner. We have maintained superior asset quality through last several years. Gross NPA and net NPA ratios moved up in the first quarter due to movement from (+) 150 DPD to (+) 120 DPD in NPA recognition norms. They have now stabilized in second quarter with GNPA of 1.87% and NNPA of 0.83%. Out of the total book, 38% of our loans, which is the HFC book, are already on (+) 90 DPD basis. We have created additional provisions in excess of RBI norms. Against gross NPAs of INR 345 crores, we have specific provisioning of 191 crores and general provisioning of 78 crores giving us total provision coverage of 78%. The legal instrument of SARFAESI Act is now available to NBFCs since August 2016 which should also strengthen our recovery repossession and liquidation efforts.

On the wealth business, we are one of the fastest growing wealth management companies in India offering wealth structuring solutions, asset management and distribution services. Our total wealth AUM crossed the magic figure of INR 1 trillion (INR 1 lakh crores). During the quarter, the team generated AUM in wide-ranging products including FMPs, equity AIFs and niche private equity funds. We have enhanced our offerings through launch of advisory propositions and direct code offerings as well as strengthened our bench strength to 200 relationship managers. IIFL Wealth aims to participate in the larger share of wallet through our diverse product offerings, family office, AIF and distribution services as well as competitive fee structures. Our wealth NBFC which commenced operations in fourth quarter FY16 offers loan against securities and margin funding to high net-worth clientele. The loan book for second quarter FY17 stood at INR 2,240 crores with an average yield of around 11.4%. From regulatory perspective, during the quarter, SEBI has released a concept paper on applicability of investment advisory regulations 2013 on firms and others involved in advisory ex incidental or distribution, other than those registered as investment advisors. This can potentially change the way the industry functions by broadening the purview of the regulations to cover distributors of MF, brokers, NBFCs involved in financial distribution and others. The impact on business operations in terms of cost relating to training, reporting, and compliance will have to be looked at in detail.

Coming to capital markets; during the quarter, the markets remained largely range bound with an upward bias. We expect the markets to remain buoyant and client participation to increase continuously. The present trend of clients investing through mutual fund route is a perfect way to increase retail participation in capital market. We are continuously enhancing our offerings on digital and mobile platforms for retail customers in our broking business. Our mobile trading app IIFL Market continues to be the highest rated app on Android and iOS amongst peers with 700,000 downloads. Since its launch in February 2015, the brokerage earned and number of clients trading on mobile is on a steady rise. D-I-Y (Do It Yourself) based mobile trading contributes to 15% to 25% of our brokerage income and above 30% of clients. The app has reached out to retail customers giving them access to research, IIFL view and advanced training tools even in Tier II locations.

For our investment banking division, it was a landmark quarter. The team crossed 10 transactions across equity capital markets, debt capital markets and advisory transactions. This comprised three IPOs, one QIP, two advisory and four debt placement transactions. Overall, IIFL has completed 18 investment banking in transactions including seven IPOs and is ranked No#2 in terms of number of IPOs completed and amount raised in the 9 months of current calendar year. IIFL's investment banking franchise has established a strong track record with marquee corporate clients - IIFL was one of the lead managers in the INR 6,000 crores IPO of ICICI Prudential Life in the last quarter. IIFL also completed INR 2,000 crores QIP of Motherson Sumi Systems, the largest QIP in this calendar year. Additionally IIFL was one of the lead managers in INR10,000 crores public issue of NCDs of DHFL, the largest public issue of NCDs in the private sector till date. The consistent deal closures of our investment banking franchise over the last two years makes us very positive on this business in the medium to long-term. The pipeline is robust with multiple deals in the various stages of execution. 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. We have the first question from the line of Pavan Ahluwalia from Laburnum Capital. Please go ahead.

Pavan Alluwalia: I had two questions, one on your retail mortgage portfolio. So when we do some market research we find that you guys are lending at slightly higher yield than some of the larger NBFCs which could mean that your underwriting riskier credit, so you are doing more of the

12% loans as opposed to 10.5%-11% loan and obviously you have got good historic reasons for that because we have a higher funding cost so to get to an ROE target you have to do somewhat more difficult lending. As our capital position has improved, as our funding costs are expected to come-off should we expect to see you guys migrating downwards to safer credits in the mortgage retail space in line with the funding costs coming off? And as your underwriting these 12% type loans in a space where there is considerable concern on fraud asset quality etc., how would you get the comfort that you are not getting trapped in underwriting credit risk that's excessively high? If you could share your thoughts on that I will be grateful. The second question is you said some very sensible things and costs in using technology to be able to cut cost. Now we hear those buzz words in just about every conference call, I was curious could you give us some specific examples of how you have employed technology, how would that help you to lower cost and how that gives you some sort of differential edge versus other people where you are ahead of the curve in using technology?

Nirmal Jain: You had two questions, one is regarding the interest rate and I think it's a very valid point. There was a point in time when our cost of funding was higher so there are two challenges; first being that your credit selection becomes a challenge and second if you have a credit selection challenge then growth is a challenge, supposing, one does a smart thing of trying to get a customer on higher rate than many times, one is not going to retain because the customer might move out after a year or two. But, if you look at our home loan interest rate from FY15, 13.3% has fallen to weighted average 10.5% in Q2FY17 and I am talking about the mortgages here. So we are very conscious of this, and if one has to achieve volume growth with quality, then obviously will have to make sure that we are very competitive in terms of interest rate.

Coming to SME, we are into a very small ticket loan which is up to INR 25 lakh or INR 50 lakh and we don't have DSA model, we work with our own people. Similarly in home loan, we are working with our own people and that is why, last five quarters, you would have seen that our average interest yield has been coming off pretty sharply. So I think, what you are saying is a very valid point and we are moving towards very aggressively towards that to become competitive in interest rate. You can have a few basis points here and there pricing advantage based on your own analytics and we are also investing a lot in data analytics to find out that how do we price based on the risk assessments that we do and how it can be vis-à-vis competitive, vis-à-vis whatever rate the competition is charging. So it is becoming a lot of science now and lot of investment is going into this but I can say that we are on the same track as you discussed.

The second thing that you spoke about is everybody is talking about the digitization and technology. Now, lot of these things are proprietary and obviously, you want to have some lead advantage over competitors in terms of what you are thinking and what you are doing. But broadly let me put it this way, everybody will try and do digitization and there is no question about it. But the most important part of digitization is the data that you get is your IPR and how we improve with that is what will make all the difference. There are many innovative initiatives that we have done like gold loan. People think that customers come to gold loan branch so what is the need to invest in mobility because we have our gold loans branches and people. If you see already in the last quarter, 83% of our business within the gold loans is on tablet. One can worry about it, somebody can take out the tablet, give the receipt to the customer. So we have thought through this project a lot. We have made it completely paperless. We have integrated back-end software of loan origination as well as recovery, audit, CRM and even HR into one device which is tablet and it gives us a lot of flexibility and lot of ease in terms of operations. And this is the innovation that won the CIO award that Prabodh spoke about. Digitisation can happen on three different fronts, one is the digital marketing which is SEO and SEM where you get the customers from Google, Facebook and everything else. The second is process digitization which is whatever you are doing physically you try and automate as much as possible. The third type, which is the more important part of it, is innovation such as our SME loans. Everything is based on a tablet so, you put 10 questions and based on that answers keyed in, instantly you can get a yes or no. Because people or customers should not be able game the system, these 10 questions will have to be randomly picked up from the server and based on every one question's answer, some other question comes up, and so lot of effort is going on. I think next 2 to 3 years we will see lot of innovation not only from us but many other players. It's just about last 2-3 months that we have seen suddenly that e-KYC, e-signing and even the UPI now has become the reality. So lot of changes has happened and I think a lot will happen in next 2 to 3 years.

Moderator: We have the next question from the line of Anita Rangan from HSBC Asset Management. Please go ahead.

Anita Rangat: My question is that IIFL Wealth's loan book has seen a very strong growth between Q1 and Q2. So has this been driven by like a one-off market phenomena, driven by IPOs or some kind of funding needs or it's more like a sustainable number which we will see going forward? Just wanted to understand what kind of a loan book that will be….

Nirmal Jain: If you look at the capital market which as a percentage of loan book has gone up from 5% to 8% that is primarily because of IPO funding which spills over a quarter end. And IPO funding is a sporadic product which is typically for less than a week's time but it's seasonal and really can't predict the volumes in this.

Anita Rangat: Just looking at IIFL Wealth loan book this INR 1,465 crores in Q1 going to INR 2,240 crores in Q2.

Nirmal Jain: The quarter end balances will have certain element of IPO funding in it.

Anita Rangat: So this will see some kind of a reversal in the subsequent quarters?

Nirmal Jain: We really don't know what will be the quarter end IPO but this time like PNB IPO has a good demand. So IPO pipeline is fairly robust. Now the numbers reported are at a point in time which is quarter end so at that point in time what will happen is very difficult to forecast.

Anita Rangat: Between your business mix if you add like mortgage retail and mortgage LAP which is like 60% what would be the mix here within mortgage between LAP and typical housing loan?

Nirmal Jain: It's now nearly almost equal so now it's becoming 50-50.

Anita Rangat: What would be the strategy going forward like it would be incrementally moving towards housing?

Nirmal Jain: If you look at our strategy by FY20 then it will become almost a large part of it, maybe 70% to 80% will become home loan or small ticket home loans.

Moderator: We will take the next question from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: So I have a couple of questions first on the Wealth side, on the Wealth side we crossly 1 trillion mark so almost we increased our assets by around 15,000 crores. So just if you can help us how could we do such a sharp growth in one quarter like where all did this growth come from like is it investment assets or advisory assets, what kind of asset did we add?

Nirmal Jain: Till now given that competitive presence in this industry, we are not sharing the breakup of investment advisory assets but there has been all-round growth, so the growth is there in domestic assets as well as global assets and our primarily focus is on growing advisory assets.

Digant Haria: Okay and can you give me the one number how much of even the structured real estate product have we done so out of this 1 trillion of assets, how much of that would be real estate linked products and you know what is your risk management system there? Because I understand that we don't keep the risk on our books it's directly on the clients' books. So if there has to be a default someday like you know how are we protected ourselves?

Nirmal Jain: So real estate is double edged sword, so on one hand it looks very attractive in terms of yield but as you rightly said that it can never be risk free because there is no free lunch in this world. But what we have done strategically over the last 2-3 years, that we have launch now incremental real estate is through an alternative investment fund. So we launched AIFs where we pull in a few real estate projects; typically, can do 10-20 real estate projects in the fund and customers invest in that. So the way it works is that, suppose you are my customer and historically might be investing in real estate debentures directly of a project A or B but now our Wealth advisors will ask you to put your money in AIF which will invest in say 10-20 projects and so that your risk gets diversified. Even though, one or two projects do not perform too well, the higher yield from other projects which will make up for the balance. I think the assets are not significant; we have around INR 3,000 crores. I don't have the precise numbers but it is in that range.

Digant Haria: Okay. Out of 1 lakh crores only Rs. 3,000 crores would be these kinds of high yields?

Nirmal Jain: In the real estate AIF product.

Digant Haria: Okay in the Wealth business it's actually a question on the numbers so our income has gone up very, very sharply so income for operations gone by say 80%. So is it largely because of the NBFC income getting added this year?

Nirmal Jain: That's right. Primarily, the significant increase has happened because of NBFC income.

Digant Haria: Okay and I assume that because we had 900 crores coming from General Atlantics so the borrowing in the wealth NBFC would hardly be around 1200-1300 crores.?

Nirmal Jain: Yeah you are right. Over a period of time, we will leverage it fully and make sure that it generates ROA but as of now the borrowings are within that range.

Digant Haria: Is there any rating differential between our main NBFC and this Wealth NBFC. Do we expect that someday they will both converge?

Nirmal Jain: No, these 2 NBFCs are different entities but they are part of the same group and rating agencies look at the group. Many a times, structured obligation where the guarantee can be from the parent entity. As of now I think it's too early because wealth NBFC hasn't borrowed much but as long as they remain part of the group that should not be a problem but if you demerge then it will be completely separate entity. So while they part of the same group but the business models are very different. So when NBFCs continue to focus on wholesale and large ticket lending to wealth customers alone whereas other NBFCs will focus on retail customer.

Digant Haria: Wouldn't that fair to assume that our wealth NBFC, the AUM or the loan book of the wealth NBFC would be fairly volatile depending on how the market opportunity is. So if we have to track it like can we track it through matrix called ROA or something or would it be too difficult right now to have such matrix for tracking the performance of the wealth NBFC?

Nirmal Jain: No, I think wealth NBFC loan book will steadily grow except for the IPO part of it. I mean if you look at INR 1 lakh crores, the credit penetration of our wealth customer is very low because if you look at globally then the big private banks will have 30% to 40% or 50% or may be much larger numbers of income coming from lending and even the leverage will be much higher. This can steadily grow except for one caveat that I said that the numbers there are reported if they have IPO funding component then there can be some volatility there.

Digant Haria: And in the last question on wealth, on the overall assets that we actually have, do we have a target that we want to achieve say 70 bps or 80 bps or what is that number which we all internally strive for and probably how far are we from that, that I can calculate but at least a target number?

Nirmal Jain: When we look at our advisory assets, 1900 basis point is what we target. Then there are some assets which are custody assets where the yields are lower. So on a weighted average basis, the yield will remain in the same range and we are fairly competitive in terms of pricing and the what we charge to the customer so, we don't really any aggressive target to take the yield up.

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

Shiva Kumar: Can you the give the breakup of the mortgage home loans. How much is it home loans and how much is it LAP? You give me incremental break up but what it is the break up for the existing AUM?

Nirmal Jain: No, the existing AUM is almost equally divided now.

Shiva Kumar: And what will be the yields for home loans and LAP on the existing book?

Nirmal Jain: As I said, the home loan portfolio is weighted average yield is 10.5% which has been falling, last quarter was 10.7%, quarter before it was 11%, before it was 11.6%. As answered during the first question, incrementally we are lot more competitive in the market.

Shiva Kumar: And what is the scenario of the yield in LAP sir?

Nirmal Jain: LAP on a weighted average basis around 12.5% to 13%.

Shiva Kumar: And regarding NBFC even though the assets quality has improved quarter-on-quarter, I noticed that the loan losses and provision had increased to 42 crores from 30 crores from last quarter. So what explains that spike?

Nirmal Jain: We have moved actually from 180 day to 120 day provisioning norms and almost 40% of our book is at 90 day provisioning norms because that is HFC book. So, we have been trying to aggressively build up. We have to take our provision coverage up and as close to 100% as possible and as quickly as possible. We are also preparing because it will become 90 day from next year from 120 day currently but as I said our 40% books is already 90 day provisioning. So, whenever there is cushion available we will try and make sure that our provision covers goes up.

Shiva Kumar: So incrementally as and when you move to 90 days there won't be an incremental increase in provision?

Nirmal Jain: We want to make sure that our net NPAs do not go up; in fact they should come down.

Shiva Kumar: Incrementally what is your target cost of fund now that you have got an upgrade from CRISIL?

Nirmal Jain: Cost of fund has come down from 10% to 9.6% and one of the key challenges we have is that many banks loans are at higher rates and many PFC bank are not accepting pre-payment. But I think we will have to further bring it down and again it's a factor of rate cut and market liquidity as well as interest rate move. But on a steady state basis, the premium that we pay over base rate or over the AAA should be further brought down by 20-30 basis points.

Shiva Kumar: Right. And going forward for the second half of the year what will be the segments which we will be targeting because for example in Q2 we saw gold loans after a long have grown their AUM so going forward for the second half of the year, what are the key segments which you will be targeting growth rate?

Nirmal Jain: No, I think in terms of order of growth so home loan will be number 1 followed by SME loans, commercial vehicle loans and gold loans. All of them should witness positive growth but the stronger growth will be in Home loan segment.

Shiva Kumar: So coming to the Wealth business, again the employee cost have increased in particular segment, are you continuing to hire people for that?

Nirmal Jain: Yeah we continue to hire people and also we have built a team for our NBFC business but yes, we increasing our manpower consistently. So we are planning for growth, if you look at total number of people in Wealth management business, they are now 604 people as compared to 550 last quarter and 429, a year ago. So, we have increased our manpower significantly. It is just that we are building capacity for medium- to long-term.

Shiva Kumar: How confident are you to that this traction would stay intact because you have grown by about 39% year-on-year to 57 crores. How confident are you because wealth business is something which kind of gives us jitters in the sense the volatility that we got to see in the profits of that particular segment how confident are you that you will be able to maintain this traction for the next coming quarters?

Nirmal Jain: Wealth growth has actually tapered off in terms of mutual funds. But, the growth that you are seeing is also contribution from NBFC; with that, we should be able to maintain because we have raised capital and our NBFC will also scale up. Further, the core business in terms of assets volume is growing. It will be difficult to say how long we will be able to maintain; it might taper off to 25-30%. But, in the next 2-3 years, as I have articulated in our growth strategy that is the rate at which we want to grow on a compounded basis.

Shiva Kumar: Sir given that the CDC money is in you are saying that you won't be requiring further more capital for at least 3 years. So can you give us the target AUM at which you might look at further capital now you are at INR 20,000 crores what would be the target AUM at which you might need further capital?

Nirmal Jain: See there are 2 important factors in this – one is how much and how aggressively securitize because that releases a significant part of capital. And two, it also depends on how well our profit is growing, what is our dividend distribution policy because the internal accruals are also available for growth. So if supposing we grow at 25-30% and our dividends are about to 15%-20% of our profits then almost 20% gets ploughed back and is available for growth. And, if we are able to securitize 5% to 10% of our portfolio incrementally, every year, then that further makes capital available for growth. INR 1000 crores infusion is almost 45-50% addition to our erstwhile net-worth. Even if we grow at 30% compounded, I am not saying that there is any guidance or any projection given, but even if we grow at 30-35% compounded then too, we should be safe and not need capital. Moreover, this is Tier-1 capital. We can have a similar amount of Tier-2 capital which is your subordinate debts and preference capital which is also available for growing the loan book.

Shiva Kumar: Recent news article which had come in in the media this is regarding the NSEL issue where in SEBIs invoking the fit and proper clause and has actually set up a 3 member's adjudication panel for some of the brokerages. So what will be the repercussions of this and what is the strategy that will follow and what is the recourse in case there is an adverse judgment from the SEBI side?

Nirmal Jain: This is a 3-year-old case, FMC has investigated most of the brokers, RBI has done investigation, EOW has done investigation and also ED has done investigation. So after three and half or four years, it is really very surprising if somebody comes up who was not regulating at that point of time with something that is radical or drastic. Newspapers have been speculating and many of these stories are fed by vested interest so I won't read too much in to it. But as far as we are concerned, we are very clear and assured by the fact that even in NSEL, we have followed all the processes that were required by the regulators or the regulatory framework as well as law of land. Of course, the regulators have right to ask questions, they have right to issue show-cause notices and get the reason that they are seeking for. The way the issue has been highlighted in media was not warranted at all and I do not think that at least whatever is my knowledge of this thing, there is any material or any significant substance in these allegations. They are trivial and frivolous.

Moderator: Thank you. The next question is from Vipul Shah from RW Equities. Please go ahead.

Vipul Shah: What would be the net-worth or book value of our subsidiary India Infoline finance as of 30th September?

Nirmal Jain: CDC money came in the allotment happened almost on 29th and 30th September only. So with that, INR 3,100 crores is the net-worth.

Moderator: Thank you. The next question is from Sanjay Parekh from Reliance Mutual Fund. Please go ahead.

Sanjay Parekh: Two questions, one is cost has been little in quite control on a consol basis so where do you see this ahead in what has been the reasons been for a cost is so well in control?

Nirmal Jain: So if we have participated in last/ earlier analyst calls over the last 2 years, we have ramped up our distribution network almost 2 years ago. We have consistently given this commentary in all the analyst calls, as the loan book grows with infrastructure already in place you get economies of scale because the same fixed cost gets spread over larger volumes. Secondly, we are also investing in digitizing; our commercial vehicle collection process and gold loan process is completely on tablet thus, we are making a lot more effort on this. We have done e-surveillance of our gold loan branches which also reduced significant part of our security cost that is typically there in these kinds of branches. So a lot of initiatives are taken place in last couple of years and a lot of them are still underway.

Sanjay Parekh: In the wealth piece, ex-NBFC how is the growth rate? I just want texture of it, I don't want numbers.

Nirmal Jain: It's fairly modest. It's not significant 15-20% type but I don't have the numbers yet.

Moderator: Thank you. We have the next question from the line of Nishchint Chawate from Kotak Securities. Please go ahead.

Nishchint Chawate: What was the breakup of distribution income between wealth management and Insurance?

Nirmal Jain: Now, insurance has become relatively insignificant. But if you look at the wealth, it will account for almost 92% of distribution income that you see in the FPD.

Nishchint Chawate: So basically life insurance in terms of income would be broadly stable on the quarter-on-quarter basis?

Nirmal Jain: On quarter-on-quarter basis there is not much change, but from the beginning of this financial year we scaled down our life insurance distribution business significantly.

Nishchint Chawate: What is the loan yield on the NBFC business?

Nirmal Jain: On aggregate loan book, it is 14.4%.

Nishchint Chawate: Any specific reason why the NIMs went up in NBFC business this quarter?

Nirmal Jain: Cost of fund has come down by 40 basis point.

Nishchint Chawate: But that would be incremental, right?

Nirmal Jain: No, total weighted average basis.

Nishchint Chawate: 40 basis point quarter-on-quarter basis?

Nirmal Jain: Yeah, quarter-on-quarter basis.

Nishchint Chawate: Okay but what is that you re-price so much?

Nirmal Jain: What is happened is we had a high cost debentures of 12-12.5% that got repaid which we have raised a three-four years ago if you remember. So that gets substituted by a much lower cost in fact last quarter. Secondly, many bank loans also got repriced but when this 12-12.5% cost kind of loan gets repaid and they get replaced by 8.8% to 9%, there is a significant saving.

Nishchint Chawate: And the infusion just had happened at the end of September so that is not point.

Nirmal Jain: CDC money has happened at the end of September

Nishchint Chawate: The couple of data point which we normally share on the NBFC business, how much was the employee expenses?

Nirmal Jain: 80.1 crores.

Nishchint Chawate: And operating expenses and depreciation break up?

Nirmal Jain: Operating and depreciation 55 crores.

Moderator: Thank you. The next question is from Pavan Ahluwalia from Laburnum Capital. Please go ahead.

Pavan Alluwalia: I think you alluded it to further potential reduction and funding cost so I was just curios we gotten ratings upgrade recently I think that rating is upgrade probably factored in some of the developments that have happened in lot 12 months, may be not all of them. So I am just curious given the incremental capital we have raised and various other things have happened, is there a path way you envisaged over the next say 12-18 months as to where you would like the rating to go and what the impact would be I am not talking about quarter-to-quarter thing but let's say 1-2 year horizon, what kind of credit rating and funding cost should we be expecting?

Nirmal Jain: So in terms of rating we are notches below the best, so we are in AA. So the path is very clear that we should be move AA+ very quickly. In 18 months' time we should target AAA. So that's what our internal target is and we want to work hard towards that.

Pavan Alluwalia: Okay and the second thing is, one of the things we have been hearing on LAP loans especially in that smaller segment that you said you have been catering to on the SME front is that collateral liquidation is becoming increasingly difficulty so if you look at the con-call transcripts from the various South Indian banks do this they saying that even the year possess someone's house which is worth 50 lakhs to a crores, liquidating that becomes a challenge. Are you seeing any of that and whole LAP are we focusing on more conservative underwriting of property values, etc., given in the real estate market in India looks very different than it did 3 or 5 years ago? Do we have our own valuer doing this or are we relaying on third party valuer and how are you taking appropriate measures to make sure that the values to which we underwrite are realistic values at which something might actually be liquidated as oppose to some theoretical value?

Nirmal Jain: Many investors have lot of concerns about LAP and maybe I will try and give some inside out view of LAP. First of all LAP is a heterogeneous product and depends a lot on the sectors.

Typically LAP is for SMEs as they borrow for working capital or their growth requirement against the collateral of property which can be a commercial property or house property. I think the key interest is that if we forecast cash flows properly then it becomes much easier because if you rely on repossession of collateral and liquidation then it will be a difficult process, not impossible. There are several cases were we have successfully done that as well but incrementally, we will hear a lots of thing about LAP because there are 100s of sectors that you can give LAP to. You can give LAP to a small time builder for his construction projects or give LAP to a trader or give LAP to an auto-ancillary company or a power unit or a transport operator or shopkeepers. LAP can be of 5-7 crores or 10 crores and can be of INR 10-20 lakh also. Geographically too, LAP has different connotation because if you give a LAP in Kerala it is really different from LAP in Gujarat. So that is why every company that is operating in LAP market will have completely different perspective of what kind of assets they have, what kind of credit process they have, what kind of yield and risk weightages they have. Having said this we have been reducing our LAP dependence significantly. When we started 5-7 year ago, we started like everybody else. We were targeting a larger 5-7 crores LAP and we learned our lessons then. We have been changing our focus as we keep learning and now incrementally we are moving toward very small ticket LAP, where the risk is dispersed; secondly, the yield is higher so the risk is priced in and thirdly, it is more process driven where the data, the subjective element of accessing is less important but the data is a lot more important. Today if you look at you LAP book, 80% of our LAP has been done on cash flow basis just as Prabodh mentioned a little while again and is based not just on collateral. So I think the LAP will remain a product but it is a misunderstood product because of the heterogeneity in its nature.

Pavan Alluwalia: The cash flow obviously you underwrite but when how value a property is that being done by you, is that being done by third parties or have changed our underwriting norms on the collateral valuation?

Nirmal Jain: So there is always a dual valuation because you can’t have your own valuer all over but internally there is some common sense validation that you do. It is done by third party valuers for the larger loans and then it is revalidated by our internal people.

Moderator: Thank you. We will take the next question from the line of Rakesh Kumar from Infinity Alternatives. Please go ahead.

Rakesh Kumar: In this quarter, we had seen the capital market book grow again. What would this essentially be and what will be your strategy around that?

Nirmal Jain: Primarily, capital market will be a volatile book because most of the capital market borrower is opportunistic and last quarter, we had IPOs and bit of a spillover of that IPO funding was at quarter end. The numbers of capital market book quarter-over-quarter basis will be a little volatile because many a times the borrowing is for different reasons. For the advance tax payments too people sometimes borrow and so typically you may see this number going up towards March end also.

Rakesh Kumar: For the large mortgage piece where do you expect because you were winding down that nicely over the couple of years. So let us say 18 months down the line do you expect how large a piece do you except that to be? Or do you expect it to be getting eliminated completely?

Nirmal Jain: Large mortgages have already gone down to 9% or so. It may further go down to 4-5% over next 2 years.

Rakesh Kumar: But you will continue having it as a product?

Nirmal Jain: Our home loan focus is through approved project financing. Some of the construction finance projects dovetail into our home loan business because you become a preferred lender when you have funded the project. But we are very selective and incrementally, it will remain as a product.

Moderator: Thank you. We will take the next question from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: The question is more on the retail mortgage so we have close to 10,300 crores retail mortgages. So just wanted to know if all of this is under Housing Finance Company structure or some of it, in the NBFC itself?

Nirmal Jain: Retail Mortgage will be in Housing Finance. You are right

Digant Haria: Okay so entire 10,300 crores will be…

Nirmal Jain: Historically we started with the NBFC but the incremental booking is done only through HFC. So those loans would get repaid in NBFC and the incremental will be in HFC.

Digant Haria: Can I get the absolute number in terms of Home loans and LAP loans?

Nirmal Jain: I think 5,000 crores each broadly give and take few 100 crores.

Digant Haria: And what targets have we set for HFC business in terms of ROAs?

Nirmal Jain: HFC business ROA - our target is around 2%.

Moderator: Thank you. As there are further questions from the participants, I hand the conference over to the Management for the closing comments.

Nirmal Jain: Thank you so much and in case anybody has anymore queries you can always write to our investor relations and we will be very happy to respond to that. Also I take this opportunity to wish all the participants and their families a very, very Happy Diwali and a very Happy Samvat Year 2073. Thank you so much.