IIFL Holdings Limited

Consolidated Financial Results – Q3FY17

Conference Call Transcript

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MANAGEMENT:

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Moderator: Ladies and Gentlemen, Welcome to the Conference Call to discuss the Consolidated Financial Results of IIFL Holdings Limited for the quarter and nine months ended December 31, 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. Nirmal Jain – Chairman, IIFL Holdings Limited. Thank you and over to you, sir.

Nirmal Jain: Thank you. Good Afternoon and thank you for being on the call. On behalf of team IIFL, I thank all of you for joining us. I am Nirmal Jain - Chairman of IIFL Group. I am accompanied by Prabodh Agarwal, our Group CFO and also R. Venkataraman, my colleague, Managing Director of IIFL Holdings Limited.

I will just take a few minutes to discuss "Macro Environment" and our "Strategy" and then hand it over to Prabodh. What I am going to talk is more relevant from the point of view of underlying assumptions for our strategy. I think demonetization is behind us now and the physical cash situation is easy. On the positive side, we are looking forward to several reforms in the budget – GST is likely to happen by July. The interest rates are falling and liquidity has suddenly become benign in formal banking system. When interest rates fall, we see that growth gets the boost; as a result, consumption as well as CAPEX goes up. Further, given the environment of demonetization and whatever backlash it had for the government and impending state elections, we can see that tax rates may be brought down in the budget for individual as well as corporate and that should be good for the macro environment as well as financial services. Also, we can see that there can be huge boost to public spending. I will not be surprised if there are many incentives for rekindling the private sector investment cycle which has more or less collapsed in last few years.

So therefore, when you look at financial services, the outlook for all our businesses is positive. Coming to our strategy, there is no change. There is a Slide #33 in our 'Presentation' which remains the same as it was earlier. For a quick recap, it is captured in '3D's. We have to double our income and our profit after tax post-minority should go up by 2.5x by FY20. Secondly, we are going to focus on making our earnings more durable and that is our lending is becoming more retail, our wealth is becoming more advisory focus and our broking is becoming more digital and online. The third 'D' is de-risking in terms of product mix, geographic spread as well as the bouquet of services that we offer for our wealth management and capital market clients.

All of you who have been there earlier would see that there is significantly more disclosure in this presentation that we sent out to you. Our endeavour is always to follow the highest standards of governance and disclosure. What we are trying to do here is capture all the questions which are frequently asked and to provide as much information as possible in this presentation so that it becomes available to all the analysts, shareholders and investors even if they are not on this call. Except for granular details which maybe relevant only for competition, more or less, everything can be found in this presentation. You will notice that in our NBFC we have provided for a detail segregating home loans, LAP, real estate and construction finance and also their NPAs, LTV, yield and ticket size. Similarly in Wealth we have provided for breakdown of advisory, custody and other assets, domestic as well as international assets.

We have added a slide on demonetization impact because there was a 60-day relaxation by RBI and I am sure many analysts would be interested in knowing how much it has really impacted the NPA provisioning and the numbers that we have disclosed. In terms of demonetization impact, I think our Capital Markets and Wealth Management businesses are not much impacted. If at all, they may be positively impacted going forward if you see higher savings and more money flowing into formal system and therefore into mutual fund as well as equities. Also, if interest rates come down to the level that we are seeing now, there will be more incentive for people to move their assets from debt and fixed income to equities. After the demonetization was announced, we saw slowdown in our disbursement of gold loans, commercial vehicle finance, home loans as well as SME by about 20-30% on a run rate basis. As we look at the month of January, we are seeing recovery except for commercial vehicles where revival is slow; in fact, even collections were impacted more in commercial vehicles (refer demonetization slide in the presentation).

In terms of performance, the minority adjustment now has become significant, in fact, the pre-minority profit is INR 222 crores and post-minority is INR 179 crores and YoY growth is 62% and 41% respectively. But only one point I would like to make here is that while last quarter we saw the full adjustment for investments done by CDC and General Atlantic and both these funds have gone into respective NBFCs. But it will take some time for us to deploy this capital fully as we leverage it over next few quarters and we should be able to improve our ROE from the new funds even better.

So with this, I hand over to Prabodh for more details about our financials and then we will take questions. Thank you.

Prabodh Agarwal: Thanks, Nirmal. I will take you through the “Key Numbers” and provide you “Business Update”. Firstly, we are very pleased to report 64% YoY growth in our group net profits to INR 225 crores; for the nine months period, our net profits have grown 46% YoY to INR 590 crores. Our net worth has reached INR 4,352 crores, having doubled in the last 2.5 years. ROE was 19.6% and ROA was 2.6%. We declared an interim dividend of INR4.50 per share, the highest so far.

All the three segments of the company, that is NBFC, Wealth and Capital Markets contributed to this strong growth.

Talking specifically about NBFC - in our NBFC business, loan AUM grew 15% YoY to INR 21,090 crores. Net profits grew by 25% YoY to INR 112 crores. Net profit for the nine months period has grown 24% YoY to INR 303 crores. The NBFC's net worth is INR 3,430 crores. We are well capitalized for the next 3-4 years of growth with Tier-1 CAR of 20.5% and total CAR of 23.4%. NBFC's ROE of 17.8% and ROA of 2.1% are healthy and expected to improve as we further leverage our balance sheet. Our volume growth moderated during the quarter as demand slowed down post demonetization. Nevertheless, we continue to move towards our objective of achieving superior loan mix i.e., reducing the share of relatively risky loans like gold loan, loan against securities and construction finance; 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. Our asset quality remains sound with GNPA of 1.80% and NNPA of 0.65%, both having declined on QoQ basis. Our NPA coverage ratio improved both on QoQ and YoY basis to 64% without considering standard asset provisioning and to 88% including standard asset provisioning. We have followed RBI guidelines post demonetization. Total loans have crossed 90 plus or 120 plus DBT threshold, not taken as NPA are INR 43.4 crores, two-third of which was for CV Loans. Product wise details of the RBI relaxation are disclosed in our presentation. However, we have actively provided on such loans. Consequently, our reported net NPA fell by 18 basis points QoQ to 0.65%. We expect much of these loans to become regular in the fourth quarter.

Besides CV, we have not witnessed stress on any other product. Our LAP book a segment where markets have generally been concerned remains in good shape. We maintain that our LAP book has a moderate LTV of less than 50%, is well diversified in terms of industries that we have lent to. 80% of our LAP is on income assessment basis or cash flow backed and 80% of it is backed by collateral of residential property.

Our retail home loan product is driven by progressively higher contribution from small ticket home loans with average ticket size of INR12-14 lakh. In our presentation, we have provided details on average ticket size, yield, LTV and NNPA for every product. Retail loans constitute nearly 85% of our loan book and are primarily focused on the lower middle class segment. Nearly 25-30% of our loans are PSL compliant which we can sell down. Currently, the securitized book stands at 10% of our AUM. Our aim is to take the securitized book up to 15-20% of our AUM over the next 12-months through higher sell-downs in mortgage retail, CV and SME Loans. This should positively impact our profitability and CAR.

Our average cost of borrowing declined by 30 basis points QoQ to 9.3%. Incrementally, we are now borrowing at an average cost of 8.2% as the cost of borrowing especially term loans from banks have collapsed in the last two months. Both availability and cost of funding have been steadily improving. In the current environment of risk averseness and low credit growth, banks are looking for borrowers with good credentials and therefore, are keen to lend to us and buy securitized pool from us.

Our NIM has expanded by 23 basis points YoY and 8 basis points QoQ to 6.3%. The NIM expansion would have been even more had it not been for rebalancing of our AUM mix towards low yielding retail homes and QoQ decline in high yielding gold and capital markets loans. Going forward, the fall in funding cost should positively impact our NIM. Cost-to-income ratio has declined by 170 basis points QoQ and 350 basis points YoY to 38.9%. Similarly, the OPEX to average ratio is also on the decline. Going forward, as our AUM grows, cost-to-income and OPEX ratios are expected to fall sharply due to better economies of scale across our products and the benefits of digitization.

NBFC headcount grew 9% YoY to just over 7,800. Number of NBFC branches have remained broadly unchanged. There has been continuous progress on digitization front with increased adoption of digital processes. All products are now live with tab-based sourcing models. Gold loan business is already on tab with nearly 100% of disbursal happening through tablets. We are the first movers to offer eSign facilities to our customers for end-to-end paperless transactions in all our gold loan branches. Due to our continued focus on investments in digitization, we had a ready platform to accept cashless modes of payment from our customers in a convenient manner, collections through tablets and a self-help portal for quick query resolution. Post demonetization, we have seen a surge in online payments from customers (the details are available in our presentation).

Coming to the Wealth business, IIFL Wealth PAT grew 45% YoY to INR 65 crores in third quarter and by 42% YoY to INR 175 crores in nine months period. Our total wealth assets grew 22% YoY and 7% QoQ to reach INR 1.07 trillion. We believe that a phase of accelerated organic growth has started with key hires being made and broadening as well as strengthening our product offering. IIFL Wealth has positioned itself to participate in a larger share of client wallet by offering family office, AIFs, estate planning and offshore advisory services, enabling a stronger penetration into the market. We have a competitive platform encompassing brokerage, NBFC and research.

In our presentation, we have provided you breakup of our wealth assets and retention yield that we earn. 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 Q3FY17 stood at INR 2,931 crores with an average yield of around 11.2%.

Coming to Capital Markets, during the quarter, the markets remain range bound with a downward bias. The quarter witnessed record FII outflows of US$11.3 billion including outflow of US$4.6 billion in equities. This was counterbalanced by DII inflows of US$5.2 billion in equities. The present trend of retail investors investing through mutual fund route is a perfect way to increase retail participation in capital markets. During the quarter, our average daily cash turnover was up 26% YoY but down sequentially by about 10%.

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 among peers with 800,000 downloads. Since its launch in February 2015, the brokerage earned and numbers of clients trading on the platform are on a steady rise. DIY (Do-It-Yourself) based mobile trading now contributes to 20% of our retail brokerage income and about 30% of our clients. The app has reached out to retail customers giving them access to research, IIFL View and advanced trading tools even in Tier-2 locations. Despite the capital markets being volatile in the last quarter, the investment banking team won three IPO mandates in the quarter across consumer discretionary, healthcare and financial services sectors. The team has completed 16 investment banking transactions in the current fiscal year including 5 IPOs. IIFL is among the top-5 banks in terms of number of equity IPOs completed in the current financial year. Given a strong pipeline we expect the deal momentum to continue.

Lastly, let me just give out the disclaimer: IIFL Holdings is a diversified financial services company with multiple businesses carried out in various subsidiaries. In today's call, we have referred to our consolidated numbers unless otherwise stated. Further, any of us may make forward-looking statements during the call based on management's current expectations; however, actual results may vary significantly. Therefore the accuracy or completeness of these expectations cannot be guaranteed.

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

Moderator: Thank you very much. We will now begin the Question-and-Answer Session. We have the first question from the line of Pawan Aluwalia from Laburnum Capital. Please go ahead.

Pawan Aluwalia: First, on the credit side, you did allude to the fact that your LAP book is pretty diversified. Could you give us some sense of how SMA-1 is moving there in terms of things that are 30-days past due, 60-days past due. At this point, how much stress should we be expecting in the LAP book over the next quarter or two because industry wide we are getting hint from various banks and NBFCs that there is stress in the segment, so to the extent that you can give us some sense of how to dimension the stress it would be very helpful? The second question is in terms of the margins you are making on Wealth Management. Obviously, very strong performance there, both in terms of gathering extra assets and in terms of maintaining a pretty healthy margin. Could you help us understand how you are able to maintain this higher margin and should we expect this 100 basis points in margin in Wealth Management to continue or would you expect that it would gravitate as you grow a little bit downwards towards 50-60-70 basis points close to industry standard?

Nirmal Jain: So your first question regarding LAP and SME. LAP is the most misunderstood product because it is heterogeneous. If you look at our LAP which we have separated from SME, the average ticket size is less than INR 1 crore. Now, this is very different from LAP which can be INR 8-10 crores on an average ticket size. So the industry is different and outlook would be different. We do not operate much in that segment. So my view will be limited. As far as MSME or SME which is less than crore rupees is concerned, I do not think there is any significant stress. In fact, if at all, things may be improving a little bit, from say, what they were about a couple of years ago. If you look at our SME book, it is new in terms of the small ticket loans. Earlier, we were mostly in healthcare equipment, where we primarily lend to doctors for medical equipments and there the performance has been generally good. Things should improve from here on, but this may be true about at least the segment that we operate in.

Coming to your second question about Wealth Management, I think our yields are reasonable and sustainable. In fact, our cost-income ratio has been a little bit on the higher side as we have been investing in growth and hiring more bankers. But, we have tried to do segment-by-segment comparison with the international private bankers like Julius Baer and many others. I think more or less we are in that range. So it is not that our yield is significantly better than private bankers in India or outside, at least as per whatever knowledge we have at this point in time.

Pawan Aluwalia: We talked about in some of the earlier con-calls about potential ratings upgrades, because obviously you have more capital now and track record, etc., Our understanding is that during the demonetization phase, the rating agencies had put any kind of reconsideration of ratings on hold. Any update in terms of whether they have been willing to resume that reconsideration process and therefore in terms of the timing over which we could expect the ratings upgrade?

Nirmal Jain: I think you are absolutely right, from a rating perspective the demonetization did not happen at a good time for us because we were just trying to present our case for an upgrade. As you said rating agencies had put everything on hold, but now I think as the dust is settling down with our results out, we can present our case again. I do not have any information from the rating agencies but logically from what we see in the environment, I think rating agencies should get confidence that things are back to normal and it is a good time for us to approach them again.

Moderator: Thank you. The next question is from the line of Ashwin Balasubramaniam from HSBC Asset Management. Please go ahead.

A Balasubramaniam: One is with regard to Gold Loan book. So I think you indicated in terms of disbursement that has been down by about 20-30% post demonetization. But if I look at it on a sort of AUM kind of basis, I think it is more or less flat. So would it be fair to assume particularly the Gold Loan segment which is short in a product that the repayments have also been quite low in this quarter especially given demonetization and given that while I think you indicated about INR 5 crores of NPAs or lower relaxation, will the early bucket sort of delays be much-much more on the higher side here and has this normalized in January?

Nirmal Jain: Our Gold Loan book on quarter-over-quarter comparison has come down from INR 3,129 crores to INR 2,986 crores. This is about INR 143 crores fall despite a strong October and the going was very good till the first week of November. If the things had continued then instead of 5-6% fall, there could have been 10-15% growth in the portfolio. I do not think there is any stress in terms of repayment. Normally, our customers pay in cash so our collection which was almost 100% cash has become 33% cashless through electronic medium. But the disbursement has slowed down. I think the book or the portfolio is fairly okay.

A Balasubramaniam: The next question is with regard to the LAP segment. So just wanted to understand post the demonetization event given uncertainty in terms of how property prices are expected to move going forward, have you become like a little bit more conservative in terms of LTVs or in terms of like installment to income ratios? Secondly, on your installment to income ratios, do you generally look only at the reported income or do you also take into fact some kind of surrogate income which is not exactly reported in the official statement?

Nirmal Jain: LAP as I spoke to Pawan Aluwalia is a very heterogeneous segment. So when we lend to SME, then the more important thing is the cash flow of the underlying business. So we try and choose sectors where outlook is positive. Typically, the LAP loan is against the collateral of the property but it is for the purpose of business unless you have funding builders, but our builder loans are separate. Surrogate income programs, we keep changing and improving. Of course it is there, but the proportion is also coming down and some of the surrogates that were not working that we keep changing and we remove and it would be new surrogate.

A Balasubramaniam: What would be the kind of installment-to-income ratio generally which you will be like lending at?

Nirmal Jain: It is little dynamic. Supposing your income is up to a particular level, then we estimate your expenditure and also look at your other debt burden, it is called debt-burden ratio. Say your income is INR 100,000 we may not exceed the debt burden ratio by say 40% but in INR 500,000 it may go up to 60%. So it varies on two-three things – one is estimated expenditure based on lifestyle, other loans and sustainability of your earnings and growth.

A Balasubramaniam: This is with regard to your home loan book. So what will be the kind of mix between let us say salaried and self-employed? Secondly, in terms of the yield, what will be the incremental yields at which you will be doing this particularly in light of I think recent cuts by almost all the major banks and NBFCs?

Nirmal Jain: 41% salaried segment form part of our Home Loan portfolio. What you are saying is right, there is pressure due to interest rate cut but cost of funds is coming down. We are also able to securitize our portfolio at a fairly attractive rate of 8% or even less than that. So that becomes in a way surrogate cost of funds for us. Also, we operate in tier-2, tier-3 and segments where generally banks do not reach out and you can at least command few basis points higher. But if you see the average rate of interest on the home loan of INR24 lakh ticket size that we get is fairly low even from banking perspective. We do not operate in the large home loan segment where the banks compete even more. Our ticket size is INR24 lakh and yield is 10.3% in the last quarter and it might come down this quarter. So it is fairly competitive. This 10.3% is also blend because we do partly surrogate and partly salaried income.

A Balasubramaniam: But the incremental yields will be roughly how much lower?

Nirmal Jain: I think as the cost of fund come down may be 30-40 basis points in this quarter, so this will be reflected in our home loan yield too. It is getting towards single-digits.

Moderator: Thank you. The next question is from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: My questions is regard to the cost-to-income ratio. So, in the NBFC we have seen a fairly healthy improvement over the last seven quarters from almost 56% in Q1 of '16 we are down to 38-39% now. How much more can we expect in this range assuming that loan book growth and the economy revives and say we do 15-20% kind of AUM growth?

Nirmal Jain: It is around 38%. So it should glide down to 35% in next 1.5-2 years. If you see the cost-to-income ratio, it varies for different products but the mix is changing and as we scale up, at least in the foreseeable future, we see it is being brought down to 35% by next year.

Digant Haria: In your Home Loans, I just remember that last time we said we are trying to do more of direct sourcing and not use the DSA channel. So are we still maintaining that particular way of going ahead with the Home Loans, right?

Nirmal Jain: Home loan is almost entirely direct actually and we do not do it through DSA. In LAP, we are increasing the proportion of direct and it is almost 40% with 60% through DSA. But, barring few cases, home loan is almost entirely done by our own staff. On INR24 lakh ticket size, it would not be viable to source it through DSA and it would not make sense for them too. The way the industry works is that the smaller home loans whether it is banks or NBFC, they have to source on their own and not through DSA.

Digant Haria: My second question is on the Wealth Management piece. I think it has been quite some time that our OPEX has been much higher than our AUM growth. I believe we have been doing a lot of hiring for the next level of growth. So would it be fair to say that now we have reached a stage where our fixed cost may probably not rise as fast or may rise in line with our AUM growth?

Prabodh Agarwal: Here, our cost-income ratio currently is around 52% given that we actually hired a lot of people in the last four quarters. Last year, our headcount went up by something like 130 as we added a lot of RMs as well as support staff. Our current headcount in the Wealth business is around 640. So all this should yield us results going forward.

Nirmal Jain: Maybe our hiring will continue for a year more at least. We are still in a growth phase, but I think it will taper off but it would not be a significant decline in the near future.

Digant Haria: Especially on the Builder segment, I believe we have like some investments through the NBFC and some through our clients in the Wealth. So how has that segment been performing like any just broad trends on that particular segment?

Nirmal Jain: It is performing well and there is not much stress. Mostly, the real estate and construction loans, when we had a product that could have been shared by our wealth investors as well as NBFC. That has become lesser now because we have got alternative investment fund. Our HNI investors invest in the fund and then the fund invests. This is not shared with NBFC. Many of the recent investments have been done by the fund where HNIs have invested, have been distinct but, we may have sponsor’s contribution of around 15%, but then it is segregated.

Moderator: Thank you. The next question is from the line of Anirban Sarkar from Equirus Securities. Please go ahead.

Anirban Sarkar: On the Wealth Management business, so you just said that RM addition might continue for the few more quarters if I am not wrong?

Nirmal Jain: Yes, but, it depends on the availability of quality people. Nonetheless, there is tremendous growth opportunity and we can still expand.

Anirban Sarkar: So sir, in that regard, what I have seen is that for the last two quarters, your AUM by RM that has increased. So what would be the sweet spot for the ideal AUM per relationship manager that you would like to see for this business if you could put a number to that?

Nirmal Jain: It is very difficult to put a number actually. Maybe we need to work on that and come back what is the sweet spot but, I think at least from the current level it can go up. It is very difficult to come to an optimum level but maybe we can think it through internally and see whether there is any optimum level that we need to target.

Anirban Sarkar: On the NBFC business, so what I see is with the capital infusion, you are very well capitalized, you can grow significantly for the next three years if I may put it that way, I see there are at least 30% growth rate should not put you in any difficulty with regard to capital. So do you have guidance on that number what kind of growth you would like to see on the NBFC AUM?

Nirmal Jain: Our guidance is there actually in the presentation, but what you are saying is right that now we are adequately capitalized and if there is an opportunity then we can grow at 30%.

Anirban Sarkar: Is it on the presentation?

Nirmal Jain: Yes, if you see the Slide #33, then we have the doubling revenue target but we should try and at least exceed those targets. So they are the target for revenue, net profit given as our 2020 vision.

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

Nishchint Chawathe: Just wanted to get a couple of data points: First of all, what is the net-worth of the NBFC business as we speak?

Nirmal Jain: Rs.3,430 crores.

Nishchint Chawathe: Breakup of operating expenses between employees expenses and others?

Prabodh Agarwal: Employees is about INR 80 crores and other expenses are INR 52 crores, depreciation is around INR 4 crores, so you can say INR 54 crores of other expenses and INR 80 crores of employee expenses.

Nishchint Chawathe: Can I also get the net-worth number for the second quarter?

Prabodh Agarwal: Last quarter was INR 3,317 crores.

Nirmal Jain: Allotment happened on the almost last day of the last Q2 i.e., towards 29th or 30th of September. So when we see the last quarter, the weighted average would be much lesser than the quarter end.

Nishchint Chawathe: On the share of cash business, I know you put out a ratio for this quarter, but can you share the ratio of cash business to the overall volume for the nine months as well?

Nirmal Jain: Nishchint, we can try and incorporate that data and send it out.

Nishchint Chawathe: Any trend on the premium collections this quarter because I guess this was a pretty interesting quarter for the Insurance business, just wanted to get how you are fairing?

Nirmal Jain: Insurance business, actually as you know that we have been bringing it down because it was sort of loss making till last year. So premium collection has not improved and it is in the range of INR 10 crores. But it is in primarily endowment products which is the highest margin, so (+90%) is endowment and growth is flattish in Q3 compared to Q2. Cost has been brought down even further.

Nishchint Chawathe: Just wanted to compare one math; when you are putting out the yield on ex-custody basis on the Wealth business, this does not include interest income or capital gains or any other fund based income, right?

Prabodh Agarwal: It includes the fees that we earn on our distribution, investment, advisory assets. It also includes the net interest income that we earn on our NBFC assets.

Moderator: Thank you. The next question is from the line of Hiren Dasani from Goldman Sachs Asset Management. Please go ahead.

Hiren Dasani: Just one small clarification; is the networth of the NBFC business is INR 3,430 crores as of December?

Prabodh Agarwal: Yes.

Hiren Dasani: Now, the NBFC business has made INR 112 crores profit during the quarter and you are saying annualized ROE is 17.8%. It does not really gel?

Prabodh Agarwal: Average net-worth for the quarter is INR 2,512 crores, which is because net-worth last year was INR 2,066 crores and this year it is INR 3,400 crores.

Hiren Dasani: But INR 1,000 crores has been there for the entire quarter, right?

Prabodh Agarwal: Yes. The ROE is calculated on average net-worth on YoY basis.

Hiren Dasani: Just one clarification again on the yield to a prior question, you answered 95 basis points yield ex-custody asset. Because this is now a blend of the NBFC operations which is net interest income as well as the fee side of the business. So if you were to just think of the pure fee-based yield, what would be that kind of number?

Nirmal Jain: If you see Slide #24, then the NBFC component is 3% of total assets. So it would not vary significantly.

Hiren Dasani: But in other words, in FY16, you did not have any NBFC-based asset, right?

Nirmal Jain: Very few basis points here and there. It would not make a material difference because we are looking at the total assets right, so the yield is on total assets where the component of NBFC is very small.

Hiren Dasani: But so around 90 basis points you think is a sustainable number?

Nirmal Jain: Ex-custody asset, yes. You make much lesser on the custody assets. So the weighted average would be lesser. We should look at the pure wealth management or real wealth management kind of piece which is separate.

Moderator: Thank you. The next question is from the line of G Vivek from GF Investments. Please go ahead.

G Vivek: First of all, I just wanted to know about how is our Mutual Fund business doing and what are the steps we are taking for improving that? What is the future looking like in terms of investment from Indian investors not going into real estate and gold and compared to that equity and how does it augur for us?

Nirmal Jain: There are two aspects of mutual fund; one is our own mutual fund which is our AMC, a subsidiary of Wealth Management. As we have said that our focus is on open architecture and we sell products of all the AMCs. So our AMC is just like any other AMC which is very small and growing.

The second part of the business is mutual fund distribution business. I think that has been growing well in our HNI and retail customer base. Now, mutual fund industry has come up age and there are more than INR 5 crores folios. We believe that in the next 5-10 years, the mutual fund industry should do very well.

About the asset allocation by investors to gold, real estate and mutual fund, if you take medium to long term horizon then I think you will see asset allocation to financial assets like equity and mutual fund increasing significantly for a few reasons – one is that the real estate has disappointed a lot and the way real estate supply is, it is unlikely that you will see any speculative capital gains. And this has been the primary attraction for people to get into real estate as they think one always makes much bigger money on speculative rise in the capital value (of the real estate). But that is no longer happening and not even expected now as more and more real estate is bought by end users who really want to live in. It will lose its charm as an investment product. Gold has risen a little bit. All the news in terms of Trump or oil has been factored in. Personally, I think you will see the moderation. Then by default you should see much faster flow of money into equity, mutual fund and financial assets.

G Vivek: One more thing was about our company, we have got some of the biggest names in the world investing in our company from marquee investors like Fairfax, EDC, DA. Do we have any plans to increasing the visibility in branding value so that our priceearning can increase, our valuation can increase, compared to others we are sort of very-very competitively priced so far?

Nirmal Jain: As a company, we do not have any plan like that, but of course what we do is I think we improve our disclosures and analyst interactions but we do not have a strategy to focus on that.

Moderator: Thank you. The next question is from the line of Shekhar Singh from Excelsior Capital. Please go ahead.

Shekhar Singh: Wanted to know about your dividend policy because this year you have given INR4.5, last year it was 4.25. Any plans in terms of increasing the dividend?

Nirmal Jain: Dividend policy is required by SEBI to be sent out to exchanges. We keep our dividend between 15% and 35% of our consolidated profit at consolidated level. Within that, the subsidiary companies' dividend can vary based on their requirements for funds. Last year, we had given INR4.25, but we had said that INR1.25 is stationed for 10th year of listing. With the profit growth this year, we are maintaining that range between 15% and 35%. We are anyway between 20% - 25% depending on full year profit.

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

Shiv Kumar: Sir, after a lot of quarters, we got to see the Construction Finance has increased on quarter-on-quarter basis by about 14%. So is there any reversal of strategy because the idea was to bring it down further and maybe increase the retail mortgage in Construction Finance?

Nirmal Jain: No-no, I do not think there is any reversal. Since other products did not grow in the past quarter, there was bit of a decline because of the demonetization impact. So it appears a little higher, but there is no change. In overall portfolio, construction finance is just about INR 2,000 crores out of INR 21,000 crores book.

Shiv Kumar: Yes, last quarter it was around 1,769, now it is 2,020. I was under the impression that slowly we are offloading Construction Finance loans to the AIF set up under Wealth business

Nirmal Jain: We have been doing that but as you see the last quarter the other retail products grew much slower and that is why it appears little higher.

Prabodh Agarwal: Just to add to your point on construction finance, earlier, we were doing a lot of these builder loans which we have stopped incrementally and all these loans are now being done through AIF. But it is not that we have completely stopped construction finance; now, the new construction finance business that we are doing dovetails with our retail home loan strategy. So we have approved project finance i.e., we approve a project where we give loans to the builder which is linked to the percentage completion and then the eventual aim is that in those projects we will give out home loans. These are the kind of construction projects that we approve and give out loans to. We have currently over 3,200 approved projects; in many of these we will be providing construction finance and the aim is that we will give out home loans in such projects.

Shiv Kumar: Sir, how big is the Affordable Housing finance segment in the overall Retail Mortgage loans?

Nirmal Jain: If you look at all our retail mortgages, the 24 lakh ticket size is more or less affordable segment but even within the underserved segments we are growing. I think we are fairly optimistic and have reasonably aggressive plans and the segment is growing very well.

Shiv Kumar: Any year-end target which you can share sir at least in terms of percentage of the overall Retail Mortgage Loans?

Nirmal Jain: It will keep growing faster than other business segments.

Shiv Kumar: What are your long term plans for this new micro finance company which you have acquired and will it need any capital going forward from your side?

Nirmal Jain: This company that we have acquired is very small and has a net-worth of around INR 14 crores and AUM of around INR 200 crores plus. If you look at our company and our strengths, then we have a wide branch network covering over 900-1,000 locations. All along what we have done is retail or small ticket finance and investment. So that is fixed to our strategy very well. As of now, we are still in the process of acquisition and we will understand the business, try to improve the technology, processes, governance there and scale it up over a period of time. In the same way as MSME loans, these loans are for income generating activities but are of a much smaller size. The industry is segregated because of RBI licensing policies and the regulations but business is similar.

Shiv Kumar: The NIMs have improved from 6.1% in Q1 to 6.4% in Q3. But with the increasing share of mortgage loans which are relatively on the lower side of the yield, do you think you will be able to sustain the trajectory of improving NIM, is there any final steady state NIM which you are aiming for?

Nirmal Jain: I think NIM will remain in this range. It may improve but say between 6% and 6.5% that is a range we should see NIMs. If the gold loan goes down, NIMs go down. If construction loan goes up, it is positive for NIM. So we are managing in that range, and if the cost of funds goes down and operating costs goes down, then it will make up for the increasing proportion of home loans.

Shiv Kumar: Gold Loans remains a focus segment, sir. You are not going to reduce its share?

Nirmal Jain: I think we said we will bring it down to around 15% level or so. So I think at this level remains fairly stable and it is a good product.

Shiv Kumar: Your outlook on the CV loan?

Nirmal Jain: CV loan might take longer to recover from the demonetization shock. So more or less, our other businesses are getting normal this month or by next month, CV might take a few months more because the whole industry is so much used to cash and the way it works. But if the economy accelerates, there is no way that CV will not catch up, but it might catch up with a lag. Also, there are a lot of emission norms which will force many people to replace their commercial vehicles. This is a cyclical industry. On trend line basis, I think growth will come back, but it might take some time.

Moderator: Thank you. The next question is from the line of Mr. Raj Jha from Edelweiss Broking. Please go ahead.

Raj Jha: Could you provide the breakup of Capital Markets in terms of revenue and PAT?

Nirmal Jain: It is already provided on Slide #4; INR 45 crores PAT from Capital Markets and Others.

Raj Jha: Sir, breakup in terms of Investment Banking, Retail and the Institutional?

Nirmal Jain: That breakup we cannot provide.

Moderator: Thank you. The next is a follow up question from the line of G Vivek from GF Investments. Please go ahead.

G Vivek: In terms of your recent acquisition of MFI, I just wanted to know about what is your take on MFI industry as such because there are two camps; one side is saying that the poor have been exploited, it is totally non-viable, so many entrepreneurs cannot be developed from such poor state out of society, what is your take on this particular line of argument?

Nirmal Jain: Yes, actually, this is what you might have heard from outside, but I have gone and met people and I do not agree with this. Little theoretical or economic answer to this question is as follows: When you run an enterprise, the inputs to enterprise are capital, labour and enterprise. When you take one extreme of steel plant, then the significant input is capital. But when you take an MFI, say making cane chairs or basket, then the significant input is labour. Or a vegetable vendor who is looking for working capital for 2-4 days of the sale in that case, your significant input is labor and enterprise. That is why the cost of capital becomes relatively less important and you can generate much higher return on capital employed and service higher rate of interest also. So in terms of the vegetable vendor who sells INR1,000 of vegetable every day, for him INR5,000 a loan is a big thing because his margin on vegetables can be much higher. In fact, it is a pity that there is a scarcity of capital there so the entire labour and enterprise is getting wasted while the return on capital they can generate is much more. There may be some exceptional cases where people are not doing things the right way, but other than that I think even the high cost of capital is still lower, than the unorganized funding that they have. And still, it is better than not having fund at all when the labour and enterprise is available.

G Vivek: How about NPA problem being faced currently in some pockets like U.P., Maharashtra, because there is no collateral?

Nirmal Jain: The demonetization impact is much worse in U.P. and North India as compared to South. The MFI that we acquired is based out of Karnataka. But I think culturally because of the political interference, the collections in U.P. have suffered loss more than the southern states. Moreover, culturally too, people in the southern states are far easier to move to electronic mode. But I think these are all transitionary phases and things should get back to normal very soon.

G Vivek: What is the opportunity size for this particular segment and NBFC in general in India?

Nirmal Jain: The way it happens, we have to make an assessment of the income generating activity and then typically the loans are given in a group, so identification of group, the group training and all these are very important factors. But yes, opportunity is huge from medium to long-term perspective.

Moderator: Thank you. As there are no further questions, I would like to hand the conference back to the management for any closing comments.

Nirmal Jain: Thank you all for being on the call. In case you need any more information, please feel free to get in touch with our IR. Now, the new email is shorter - IR@IIFL.com. We will be happy to respond to the questions.

Moderator: Thank you very much. On behalf of the IIFL Group, that concludes this conference.