"IIFL Finance Limited Q2 FY-23 Earnings Conference Call"

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MANAGEMENT: **MR. NIRMAL JAIN – MANAGING DIRECTOR.**
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MR. MONU RATRA – CEO, IIFL HOME FINANCE
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Moderator: Good day ladies and gentleman and welcome to the Q2 FY23 Earnings Conference Call of IIFL Finance Limited. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Rajesh Rajak – Chief Financial Officer. Thank you, and over to you sir.

Rajesh Rajak: Good day everyone. I am Rajesh Rajak – Chief Financial Officer. Thank you all for joining us on this call. On behalf of the entire team at IIFL Finance I would like to extend best wishes for Diwali and a very prosperous New Year ahead to all of you.

On this call I'm accompanied by Mr. Nirmal Jain – our Managing Director, Mr. Monu Ratra – CEO of IIFL Home Finance; Mr. N Venkatesh – CEO, IIFL Samasta Finance and Mr. Kapish Jain – Deputy CFO and Head Investor Relations.

I'll hand over to our Managing Director – Mr. Nirmal Jain to comment on the economy and the group's overall strategy and plans. Over to you sir.

Nirmal Jain: Thank you Rajesh. I hope all of you had a good Diwali and I wish you and your family and loved ones a very Happy New Year. So, to begin with, I think India's macroeconomic fundamentals are very strong. India stands out as the bright spot in a gloomy world. This is where investors can expect visibility of earnings growth, political and economic stability, favorable demographics and something that is not talked about much is the fact that India has leapfrogged the rest of the world to build the best-in-class digital India for a billion people to ride on.

And the sector that is most impacted and is crucial for economic growth is financial services. India has come a long way on the agenda of financial inclusion. Still, finance and credit have not reached several millions. All the banks' branch network still is not able to reach out to all the needy borrowers and there's a growing realization amongst the policymakers, that banks and NBFCs have to work together to achieve the goals of financial inclusion quicker and Fintechs have a role to play as well. But there are 1000s of Fintechs that have mushroomed all over so it's no brainer that they'll be high mortality there. RBI has security guidelines to prevent systemic issues by unbridled credit products from non-regulated entities. In fact, RBI's timely intervention is the biggest shot in the arm for Fintech industry. The orderly growth of Fintech will facilitate breakthrough innovations and solutions for credit to the masses and our PM said it very rightly a few days ago, that Fintech will lead to financial revolution.

Coming to IIFL Finance:

We are in the sweet spot to seize the opportunity and participate meaningfully in India's financial inclusion drive. Besides in house team driving digital innovation and innovative solutions, we have brand balance sheet and branches. I believe that we are at the cusp of unprecedented growth opportunity and we augment our organic effort to acquire new customers through partnerships such as OPEN and very recently ZestMoney to reach out to the underserved customers and access their data with consent for instant loans. We continue to look for alliances and innovative partners and for balance sheet we continue to partner with banks through co-lending and direct assignment. Last quarter, our co-lending book grew 32% quarter-on-quarter. This quarter is a watershed quarter in my opinion, because our differentiated strategy of retail on one end and the partnership on the other end is getting vindicated by the performance and perceptible potential. Our vision is to be the most respected non-bank in India - our innovation, quality growth, customer centricity and not only meeting but exceeding all the stakeholder’s expectations. So, last quarter, we achieved healthy profit growth but more importantly we also improved our asset quality and we reduced our gearing further. And this quarter we have taken the standards even higher we are added a section with business and financial details of all group entities, namely the holding company, the standalone NBFC, the housing finance company and the microfinance company as well separately and reconciliation to show how they are consolidated in the reported numbers.

So, thank you with this I hand over this to our CFO.

Rajesh Rajak: IIFL Finance profit after tax before non-controlling interest for the quarter was the highest ever at Rs.397 crores which is up 36% up on a year-on-year basis and 20% up quarter-on-quarter. This was driven largely by volume growth and lower credit cost. We recorded pre provision operating profit of Rs.685 crores during the quarter, which was again up 23% on a year-on-year basis and 2% quarter-on-quarter.

Loan AUM grew by 25% year-on-year and 5% quarter-on-quarter to Rs. 55,302 cores. Our core products grew faster at 28% year-on-year and 5% quarter-on-quarter to Rs. 52,221 crores driven mainly by low ticket home loan, gold loan and microfinance loans. Our non-core loan AUM primarily construction and real estate financing shrank by 9% year-on-year in-line with our strategy. 95% of our loans are retail in nature and 69% of our retail loans are PSL compliant, which is excluding gold loans which are not classified as PSL loans under extant RBI regulations. Lastly the retail and PSL compliant loans are of significant value in the current environment where we can sell down these loans to raise long term resources. In-line with a capital optimizing strategy. 39% of our AUM is either assigned, securitized or under co-lending as of September 2022, which is up from 35% during the same period last year. During the quarter IIFL Finance tied up with South Indian bank and Karur Vysya Bank for co-lending of gold loans and Indian bank for business loans.

During the half year, we added over 450 branches and over 4000 employees. As a result, cost to income ratio has increased to 43% in H1FY23 from 40%in FY22, but this paves the way for accelerated growth in the future. Annualized return on equity for the quarter just ended is at 20.4% and the annualized ROA is at 3.4 %. Capital adequacy ratio is at 21.7% which is well above the statutory requirement of 15%. As a result of the improved credit profile of the company our quarterly average cost of borrowing declined three basis point quarter-on-quarter and 29 basis points year-on-year to 8.4%. Gross NPA stood at 2.4% and net at 1.2% as at

September which is down from 2.6 and 1.6% respectively from the previous quarter. A provision coverage on NPA is now 147% which is up from 137% in the previous quarter. Earnings per share for the quarter not annualized stood at Rs.10 per share which is up 30% on a year-on-year basis in-line with the increase in profits and a book value per share is at Rs.215.2 which is up 41% year-on-year.

A brief update on liquidity during the raise approximately Rs.3,800 crores in debt and in addition we assigned loans worth Rs.3,500 crores during the quarter. Our cash and cash equivalents and committed credit lines from banks and institutions of Rs.8,191 crores were available as at quarter end, adequate to meet not only the near term liabilities but also to fund the growth momentum. We have a positive ALM whereby inflows cover or exceed expected outflows across all buckets and net debt to equity ratio is at 3.1x which is down from 5X as on September 21. IIFL Home Finance the subsidiary received Rs.2,200 crores from ADIA in August 2022 thereby boosting the net worth of IIFL Home Finance by more than 80%. This will help the company consolidate its competitive position in the affordable housing finance market in India. It has tremendous long term growth potential. This also gives us a gunpowder to tap the growth opportunity in the housing segment. With affordability index at a decade high we believe that the dip in the rate, it will be well absorbed by the customer with marginal hiccups.

The total liquidity of the group now standard Rs.9,480 crores. IIFL Finance has entered into a partnership with ZestMoney which is India’s leading and fastest growing digital EMI checkout financing platform to offer credit to potentially millions of new to credit customers. Through this industry first partnership, IIFL Finance, as a dedicated partner will get access to a new customer base on the Zest platform and play a crucial role in driving financial inclusion for a large section of people in the country.

A little bit of digital updates, we continue to focus on digitization and analytics to improve customer experience and enable a convenient one stop shop for purchase and investor needs. During the previous quarters we had mentioned about our DIY, Digital Initiative for disbursement through WhatsApp and MyMoney. More than 60,000 customers have been onboarded till date under these initiatives. During the quarter the DIY disbursements were Rs.350 crores up 36% quarter-on-quarter. Our gold loan at home initiative which started approximately a year ago, also saw significant traction with disbursements increasing, 118% year-on-year to Rs.227 crores during the quarter. IIFL loans app and MyMoney app is being increasingly used by our customers for various transactions, and thereby giving customers ease and convenience. We have more than 3,50,000 average monthly active users across both these apps. With this, we come to an end update and we can now open the floor to questions. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Harsh Shah from L&T Mutual Fund. Please go ahead.

Harsh Shah: First question is on the opening remarks that Rajesh just said, you had mentioned that the overall cost of fund has gone down, can you just explain how?

Rajesh Rajak: Three things which are responsible for this. Number one is, we have bought back approximately $100 million worth of our overseas bonds and replaced them with low cost rupee financing, under ECB. So, basically, we have had a gain on that and if you remember, our second lot of buybacks were done at a lower than par also. And increasingly our off book loan assignments, which was 35%, last September has now become 39%. So, that also gives us a significant advantage, because the direct assignment of the stronger asset comes in at a lower cost of funds. So, it's really a combination of all this. Also Samasta Microfinance approximately a year ago, got upgraded, the credit rating got upgraded from A+ to AA-, which is probably just one or two MFIs in the whole country to have the rating. So, it's really a combination of all these factors that have contributed to the stable cost of funds till now in a rising rate environment.

Harsh Shah: So, if I just remove the co-lending and off book funding that you get, like I'm just referring to your PPT in which you have given.

Nirmal Jain: As the primary thing, the dollar bonds are very expensive, because they're fully hedged cost was closer to level 11%, the dollar bond that we raised in February 2020 in the wake of liquidity crisis, so, as we repay the dollar bond, we can remove the hedging also, so the total cost comes down. We can replace this kind of cost with 8-9%, and save money.

Rajesh Rajak: One more thing, Harsh, the bond is anyways due for maturity in April 23. We have adequate liquidity to repay that and with that slightly higher-cost borrowing going off the books, we should see more stability going forward.

Nirmal Jain: If given the opportunity we'll probably try and buy back entire thing**.**

Harsh Shah: Understood sir. And second question is, you've done some small accounting change this time, you had mentioned it in your P&L that the spreads on co-lending has been now classified under non fund base, so can you just help us understand how that works?

Nirmal Jain: In case of co-lending, suppose we lend to 20% and bank basically have their share at 80%. So, on the 20% component we will account for 15% interest as interest income, on the remaining 80% of component banks will charge 6% which go as non-fund base income. So, when we just started, the entire thing was being taken as interest income but now we are trying to adjust it because if you understand the underlying assumption is that 80% assets are not in our books.

Harsh Shah: Correct. 20% will go into interest income and rest 80% will go to non-fund based?

Nirmal Jain: You are right. Now the co-lending is becoming significant it might be visible but of the remaining 80%, difference of the excess interest on our share will go as non-fund income.

Harsh Shah: Understood sir. Just last question from my side, AUM growth you have been quite vocal of maintaining at current run rate plus, minus few basis points. But considering how strong your ROA was in this quarter you think for the balance of at least H2 you will maintain it or is there also further scope of increase in this ROA?

Nirmal Jain: We should target to maintain it, given the fact that there'll be upward pressure on interest cost and liquidity has tightened significantly in the system now.

Harsh Shah: Understood and has there been any changes in your OPEX strategy because even OPEX as a percentage of total AUM has been inching upwards?

Nirmal Jain: OPEX as a percentage of total AUM has gone up because the branch expansion that we have done very aggressively. We had a large number of new branches more than 400 new branches, commissioning in last quarter. The full impact, of cost comes in this quarter, but going forward should plateau and should start coming down as we slow down the pace of branch expansion.

Moderator: Thank you. The next question is from the line of Sukriti Jiwarajka from Laburnum Capital. Please go ahead.

Sukriti Jiwarajka: My first question is on gold loans. As this is one of the core segments that you highlight for growth, there was sort of price competition that we saw last year between NBFCs that has abated a little bit, you do see banks, especially HDFC Bank saying that they want to expand gold across our branches, let's say Maharashtra, they want to take gold from 1500 branches to 3000 branches in the next two years. So, this will have an impact on NBFCs and there has been a discussion in the past where you say that banks can't do gold loans like NBFCs can, but when a large bank comes and says that they want to expand consumer gold loans to so many more branches and have the gold valuer every day in the branch. It'll impact you in one of two ways, either growth or the sort of the 15% to 20% yields that you earn in gold today, because they will probably do it at 13%, 12%. So, what do you think about that am I seeing this wrong and if yes, then how would you counter that?

Nirmal Jain: Actually, your point is valid. That is what is seen in the gold loan business results so far and in our gold loan as well. So, if you see our growth is very modest, given the fact that we expanded our branch network by 40% in the last 18 months, but quarter-over-quarter we have been able to manage just 4% growth. So, either you compromise significantly on yield or your loan growth will be muted because of intense competition from banks. If you look at last 10 or 12 years, what happens is many times we have seen that the NBFCs and Fintechs basically jump in because optically it looks like the NIM is very high and very attractive for a relatively zero risk kind of a business. But typically, gold loan operating cost is maybe around percent for a relatively mature kind of a business of the loan AUM. So, it's not that the margin or any interest rates of 16%-18% is exorbitant. Also it's very vulnerable to fraud and robberies and many other things. Now, if you go back six months or 12 months and most of the banks were scrambling for retail assets and loan growth, that is the time probably most of the banks also jumped on to this but these are small ticket loan item where the growth is not so rapid. Many new Fintechs and new NBFCs that were doing the loss making kind of price offer like Rs.0.54%, which means around 6% or 7% per annum, have already withdrawn. So, I think the sense has already started to prevail in terms of the competition, in terms of banks also, we try and target the regions, and geographies which are not easily accessible to bank. Now, with a new branch, our focus will be on that. It is a neighborhood business as nobody goes from Andheri to Virar to take a gold loan. So, we're working on our strategy and we are also working on a strategy to make sure that the cross sell, the fee income and all those go up through this customer base significantly. But your point is valid, that the competition has intensified and banks are becoming very aggressive, in fact on to the yield and the growth.

Sukriti Jiwarajka: Got it. The second question is on the assignment income. Now, this Rs.418 crores of assignment and co-lending. Have you divided this anywhere between how much is from assignment and how much is from co-lending?

Nirmal Jain: Maybe from next quarter we will start or maybe we'll try and figure out how do we disclosure it separately. We have to divide it into the upfronted portion, the NIM portion and then the amortization and the fee portion. So, we will work on these numbers, but right now, I don't have it.

Sukriti Jiwarajka: Yes, so the declining trend is probably because a lot of upfront is turning into amortized. I think that would be it. Correct?

Nirmal Jain: Yes, I see the declining trend is understandable, because in co-lending we are not upfronting anything, getting interest as it is every quarter. But in case of assignment based on IndAS accounting policy, you make up some conservative estimate and because the risk is off the balance sheet, we end up up-fronting the discounted value of the income. So, as we move to co-lending more and more, the up-fronted portion will keep reducing and flow of interest income on an accrual basis will increase.

Sukriti Jiwarajka: Okay, got it makes sense. Also the write off this quarter we didn't see anywhere in the PPT, maybe I missed that?

Nirmal Jain: Write offs and provision for losses, the loan losses provisions and write offs are all together in that amount of Rs.196 crores.

Sukriti Jiwarajka: No, what is the write off?

Nirmal Jain: The amount is all included.

Sukriti Jiwarajka: Okay. Also, you just mentioned to the last person who came before me that this dollar off shore bonds has been replaced which was a reason for the cost remaining where it is or actually going down a little bit. How much of today's borrowings now are these dollar offshore bonds and how much are you looking to replace over the next few quarters years and what sort of cost of funds advantage can we get from that?

Nirmal Jain: There are two types of dollar exposure that we have and both are hedged, so one is the dollar bond issue that we did, which is kind of a public offering kind of issue, where you are open, get the bid and do that. So, there was about $400 million that we did in February 2020, out of which about little over than $130 million we already bought back. So, $270 million is the outstanding out of that issue and then there are ECB loans which you really can't repay because you can't buy back. The dollar bonds are the listed bonds - this $400 million that we did in Feb 20, so with the listed bonds you can try and buy back whenever the market is there, see today if you see the yield on all emerging market bonds has gone up, even good quality banks' bonds also are available at a very attractive dollar yield. So, out of $400 million, $130 million we have bought back, $270 million is still outside which we will try to buyback if we don't then we just have to repay in April 2023.

Sukriti Jiwarajka: Okay. I have one more question. So, actually business loans, had a particularly good quarter, the growth run rate went up, NPAs came down you also provided more for this book. There was an arrangement with OPEN last quarter. Is there something now that you would say this is in your sort of core growth segment because traditionally you used to always serve home loan, gold loan, and MFI as your core segments. Where is business loans, how do you think about it in terms of growth and what are these, these are really, are these term loans or are these working capital loans or are these LAP loans?

Nirmal Jain: This is the core growth segment for sure. So, we'll have a four core businesses which is home loan, gold loan, microfinance and business loan and within business loans, the larger loans, we target against the proper quality of property and the smaller loans will be unsecured. Now, typically all the loans basically they are called term loans and we really don't do overdraft like banks do, but these terms are also taken by these businesses for working capital requirements, specifically unsecured loans primarily for working capital requirement. So, if you look at the average ticket size of our loan, incrementally for unsecured loans we have Rs.4 to 5 lakh and all put together the ticket size has been coming down, Rs.6.1 lakh was in the last quarter but incrementally is around Rs.10 to Rs.20 lakhs. So, what had happened is historically we had a larger LAP that business we discontinued. So, quarter-after-quarter you see that this is coming down and so, these are all small businesses like shopkeepers, traders, these freight operators or sometimes these, self-employed professionals or people who are self-employed nonprofessional all the people who are running any kind of business and these are typically small businesses. So, that is what we'll be targeting as a core growth thrust and open partnership and many other partnerships that we look for is this kind of business.

Sukriti Jiwarajka: You are actively doing unsecured in the business loans segment today?

Nirmal Jain: Yes. we are doing unsecured also. So, if you see for the quarter, it is a split of 75:25, 75% is secured and 25% unsecured in our book currently.

Sukriti Jiwarajka: And in the disbursement?

Nirmal Jain: Okay, what happened disbursement unsecured maybe slightly more, but the tenor is shorter. So in terms of portfolio it's 75:25 and disbursement maybe sort of 2/3: 1/3

Moderator: Thank you. The next question is from the line of Anusha Raheja from Dalal & Broacha. Please go ahead.

Anusha Raheja: I'm saying how do you see growth panning out for the balance part of the year?

Nirmal Jain: The balance part of the year growth should be equally good or better, we should be able to sustain the growth and margins both. Right now the environment looking very positive in terms of demand for credit, and the bank's willingness to partner and the economy is doing well. So, actually most of the businesses are coming back on track and they take in a business loan as well as gold loan. Even a real estate sector the interesting thing is while the interest rates might have gone up, but they have not slowed down because builders have kept the nominal prices down or they have not increased the prices. So, because they are also have been devalued basically now sell and liquidate. So, we are seeing good demand for all businesses, microfinance also has picked up very well and the entire industry it has picked up very well in last quarter. So, it looks like the outlook for the next two quarters is good as well.

Anusha Raheja: Okay. And what were your net interest margins in Q2?

Nirmal Jain: Is around 8%.

Anusha Raheja: It's around 8%. What are the incremental yields and the cost of funds, if you have that numbers with you?

Nirmal Jain: Rajesh mentioned that we were able to bring cost of funds down in last quarter, by a repayment of the high-cost dollar bonds. So, they are flattish it is not that there's not much basis point decline, the yield on an overall level has gone up because interest rates have gone up, also so the portfolio yield is 15.5% for the quarter as compared to 15.3% so steady basis point increase in the yield. In the cost of funds, there was a decline of around 10 basis point decline there. So, margins have improved by 30 basis points that way.

Anusha Raheja: Just one last question, on the OPEX side in last two three odd quarters we have seen sizable amount of branch expansion. So, going forward any outlook on the OPEX side what are your plans to roll out branches in terms of employee expenses, any guidance there on the OPEX side?

Nirmal Jain: The operating cost will be doubled, because our network has become much bigger. So, last quarter-on-quarter the OPEX increased around 7%. I think that 4% to 5% is something that can continue for a couple of quarters and in year 23-24, we will have to take a call on the strategy that we will continue with our branch expansion or slowing down. Now, that again depends on the business environment, because if you feel more confident and more positive then we can continue to expand the network and still maintain the return on assets, then you need to expand the network. But at this point in time, it might plateau, it's not going to come down significantly, but it won't increase in any rapid manner also.

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

Deepak Poddar: So, I just wanted to understand over all on the credit cost front and now excess provisioning that we have been doing for last couple of quarters driven by the RBI policy. So, we are through with that?

Nirmal Jain: So, actually we are pretty close to our guidance, so credit cost is coming down, we should continue the trend on a relative basis, relative to the portfolio or relative to the loan book. So, we are on the right track there. We have a loan book of more than Rs.35000 Cr and for a quarter if you take 50 basis point it's 135, but our credit cost this quarter is 196. So, we're pretty close so guidance, it has to actually be anywhere between 150 to 200 basis points in a year and over next two, three quarters we should move towards that.

Deepak Poddar: 150 to 200 basis points credit cost and this number is built on the on-book's premium right not on total AUM?

Nirmal Jain: Yes, this number is on book AUM, not on total AUM. So, what happens is that, we have to worry about our on book AUM only and not on the total AUM.

Moderator: Thank you. The next question is from the line of Kashyap Javeri from Emkay Investment Managers. Please go ahead.

Kashyap Javeri: Sorry to harp on this, but to the earlier question on co-lending lending, when this 80% of the book gets transferred to banks, I understand that the whole risk also transfers from our book to their book, if that's correct, and that in which case the accounting of income will then be similar to what we do for assignments. Or we sort of amortize the income over the life of the asset, which has been transferred?

Nirmal Jain: Exactly, so here it gets amortized over the life and whatever we do is based on the IndAS accounting and auditors' guidance, so I believe that all the company will do the similar way. So, what is happening in case of assignment, supposing you have a seven-year loan, and I say you're going to make a margin of 10%. So, you will basically say 10% for seven years, you will discount to present value. Then you reduce the operating cost and we might get repaid before seven years and then you take only for four years and you discount and you reduce the cost and then you upfront it. But in case of co-lending doesn't work like this and you'll accrue every quarter, every year as it comes.

Kashyap Javeri: And the rate that you pay out you will account as the expense over there and in the other income you would do the net numbers.

Nirmal Jain: No, you don't have to net because interest directly goes to them from the customer. So, money from the escrows, just straight away goes to your respective partners or we collect on behalf of the bank as an agent and we do that.

Kashyap Javeri: Okay. And just last clarification, in which case you in the other income, you will account for only that spread, the differential?

Nirmal Jain: That is right, on the 80% component, or 90% or 70%. Now in co-lending also this percentage varies.

Moderator: Thank you. The next question is from the line of Darshil Pandya from Fintrust Capital. Please go ahead.

Darshil Pandya: Sir my question is on the microfinance segment, it is contributing around 12% to the AUM and we have seen a year-on-year growth of 49% and we have come in from probably Rs.840 crores in FY18 to Rs.6000 crores of AUM in FY22. Sir, do you see this number more getting up, contributing more to the revenues because, the market opportunity is very big as we have mentioned in the investor presentation, and we are putting up well, so, where do you see this number going on sir?

Nirmal Jain: This year growth is basically because of the lower base of last year, last two years it has not grown, so in a way it is catching up and also we expanded the branch network. So, we would like to be a meaningful player in the industry. So, we are amongst top 10, but we like to be amongst top five or top three for sure. So, business will grow, the 49% or 25% -30% that is all matter of depending on how they do businesses. But our objective will be to grow a little faster in the industry not too much faster and not too slower.

Darshil Pandya: Right. And sir also something on this gross GNPA and NNPA?

Nirmal Jain: About the micro-finance or overall business?

Darshil Pandya: About the micro-finance

Nirmal Jain: Incrementally, we are seeing a good quality asset so, GNPA and NNPA will come down in this business unless something which is unforeseen or a black swan event happens again.

Darshil Pandya: Okay. And any specific sector that we are giving up loans to microfinance segment?

Nirmal Jain: No, not really, because we have branches in the suburbs, urban as well as rural areas. So, primarily they go to these women for cottage industries.

Moderator: Thank you. The next question is from the line of Nikhil Agarwal from Tusk Investments. Please go ahead.

Nikhil Agarwal: My question is on the investments books; we have Rs.1400 crores of investments in this quarter. Can you explain the terms of this investment and what is the collections, repayments status and recovery that we can get in this investment book?

Nirmal Jain: Yes, so actually we got an Andhra bonds of Rs.500 crores which is part of our liquidity Andhra state boards and then there are SR of some assets that are transferred to ARC and there is an AIF. So, all these assets are valued every quarter based on the recoverability only and marked to market wherever required is provided for. So, we get them valued and rated every quarter by the auditors. Rating agencies like CRISIL also does the assessment and based on that we provide from mark-to-market so value that you see is all recoverable.

Nikhil Agarwal: Okay and what is the interest rate and the return we can expect with this book, because a lot of this book is also containing the AIF as a CRE book which we used to have and do you aim to increase that to Rs.3700 crores, that was the guidance which you have given**?**

Nirmal Jain: Broadly, you can say that around for various instruments from 7% to 9%.

Nikhil Agarwal: Okay and is there any further detail that you have on the book in terms of the asset qualities in AIF?

Nirmal Jain: The real estate asset that we've transferred to AIF, they are doing better now, because the environment has improved and quality of the real estate part of it has improved, even in the ARC assets we had a reasonably good recovery in last quarter. So, in a way, as the economy improves, the real estate sector improves, the asset quality is improving.

Nikhil Agarwal: Got it sir. I have one last question on the microfinance book. Sir this quarter again we have seen some very high provisions similar to last quarter. last quarter we had mentioned that a huge part of the restructured book had come out of restructuring. So, how do you see this panning out going forward, because the ROE in the business is now quite low, the half year ROE.

Nirmal Jain: Yes, so as I said last quarter also, the call that we took last year of giving moratorium and restructuring as the book comes out of that we are seeing that there are a lot of delinquencies there. We are forced to take write off in microfinance, because above 90 days is to be fully provided. Therefore, the microfinance ROE is abysmally low against what historical trend has been, this will continue for another two quarters and we start tapering of probably, we should be able to set it back next year. All the businesses that we do, our target is to have 20% ROE and this is as of now is depressing, but we are working on it. Give us two more quarters for this.

Moderator: Thank you. The next question is from the line of Jigar Jani from Edelweiss Wealth. Please go ahead.

Jigar Jani: My question is on the stage two assets, that especially in the gold loan side, so starting from Q4 onwards if you see stage two assets on the gold loan side they have gone from 4.9% of the gold loan book to almost crossing 11% now. Any particular reason why we are seeing such a sharp rise especially gold loan from the stage two side. Even on an overall basis that is pushed up our stage two effects of 5.5% in Q4 to almost 7%. So, any color on that why there is such an increase. Also same is seen partly in home loans, to some extent not as sharp as gold loans but quarter-on-quarter we are seeing increases in stage two assets.

Nirmal Jain: The stage two in the gold loan has gone up from Rs.662 crores to Rs.843 crores in a quarter-on-quarter, partly because of the book growth and partly even as in festival time sometimes the collection gets a little bit delayed. So, there's some psychology in customers and industry, the way it operates, they try to collect it in 90 days. So, you see it in Stage-2, but normally there's gold collateral and the risk to the customer also, so they don't go beyond 90. It's just a question of collection efficiency and putting a little bit more pressure on the system to track it carefully. But it's gone up a little bit with the book also with maybe some bit of collection delays. Typically, people are not going to default. So, normally people don't force you till the 90 days to get to deliver to account. Customer can be sometimes lax sometimes**,** but point is noted

Jigar Jani: Right. And for home loans also is the same case?

Nirmal Jain: Home loan is slightly increased with the book growth also. So, there has been some increase but that's not very significant.

Jigar Jani: So, is it possible to share the one DPD plus for the home loan book?

Nirmal Jain: Right now we don't have it, but I will note the point that whether we should have one DPD plus separately. In home loan it is broadly around Rs.1300 crore one DPD plus.

Jigar Jani: Just last, if this early indicators of stage two go up say this is only for our own book which is on book, but I believe similar performance will be replicated on your assigned book, on your co-lending book. So, does it impact your ability or are there any repercussions on asset quality or credit cost side for us, I know it's fully risk off. But on the co-lending side, are there any clauses wherein if the asset quality deteriorates especially for book that we have originated, we need to provide more or share more of the risk or something of that sort?

Nirmal Jain: So, at this point in time, I don't see any stress or any challenge there because this is something which not worse than the rest of the industry, or the banks their own portfolio typically so that is how we look at it.

Moderator: There is a follow up question from the line of Anusha Raheja from Dalal & Broacha. Please go ahead.

Anusha Raheja: Sir, what is the return that you would be expecting from your AIF book, CRE book which was sold to AIF given the fact that the real estate sectors has been improving. What are the basically terms of profit sharing, for that side?

Nirmal Jain: Till we fully redeem the book, which maybe another two- three years it will be very difficult to take any guess on that. So, at this point in time, it's a very difficult question What happens is if there are ten investments, some will do very well, some will not so well and we'll discover the entire thing when the full book is liquidated completely in another two, maybe two and a half years.

Anusha Raheja: Okay. And sir you said that you have still $270 billion of bonds on your book which are high cost. So, those bonds might come up for re-pricing is this fiscal**.**

Nirmal Jain: These bonds are fixed rate bonds.

Anusha Raheja: Okay. So, whenever you redeem that, probably that might get also replaced by lower cost so you might have a benefit of, margin expansion from that as well.

Nirmal Jain: That's absolutely right, because this $270 million still we are building in terms of cost. So, when we do that there'll be some cost performance advantage there also.

Anusha Raheja: So, that might come in next fiscal FY24?

Nirmal Jain: Yes. Mostly in fiscal 24. It is a small buyback but otherwise they will come primarily in fiscal 24. What is happening now is the bond holders are also not selling, because they know that within six months they will get the full money. So, why sell at a discount, so we don't get liquidity in the market and then they know our track record that we have bought back most of it wherever there is liquidity. So, it will come one shot somewhere in April 23.

Anusha Raheja: I missed out to your accounting treatment on co-lending book, if you can just elaborate more on that?

Rajesh Rajak: I want to clarify for everybody this is not a change in accounting treatment, the accounting has always been the same. For the presentation purposes, we are only reclassified it from net interest income to non-fund-based income. So, the accounting has been consistent, as we also explained on this call, is that we take the margin on that 80%, which is the bank share and that was in the interest income, now it is included in non-fund base income, so it's only a reclassification, not a change in accounting.

Nirmal Jain: Yes, reclassification for only the analyst presentation, but there is no change in accounting.

Moderator: Thank you. Next question is from the line of Tushar Sarda from Athena Investment. Please go ahead.

Tushar Sarda: I wanted to understand, the valuation basis for selling 20% stake to ADIA. When I compare it with other listed housing finance companies, it looks very cheap. So, if you can share your thoughts on this?

Nirmal Jain: So, I think it very difficult question to answer but what has happened is that the listed companies when you compare there are some outlier and valued significantly higher but most would be a long tail in the housing finance will be generally much lower. If you really look at the valuations for what we got, and based on historical book value, it was at maybe 3.5-4 times, but if you really look at the entire housing finance universe, there are one or two companies where the valuations are higher that is one. Secondly, what happened that, to be very candid there was also overhang of the parent company valuation. And thirdly, although if you look at our track record, then all the investors have basically made significant multiples on their investment and we generally keep something on the table so that the investors have a good exit. So, if you look at CDC, ADIA, Fairfax or Carlyle all of them have made a lot of money on our investments.

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

Sharaj Singh: Just a clarification on the earlier question on default protection that we might have to provide on the co-lending book that we originate, so did you say that the banks have not asked for any such default protection. So, in future they might or there is no such thing here?

Nirmal Jain: There is no such thing possible as per the RBI policies and guidelines. See what happens is the banks take any default protection then they can't claim it as a primary sector asset because RBI is very clear. When you are doing private sector, the loans and the risks would be with the bank. Secondly, the risk is priced in so, I won't give a price also and risk cover also. So, the way all these transactions happen, they are without any recourse in terms of risk and structurally there's no other way to do this based on RBI policy also. See RBI is encouraging co-lending because banks have a balance sheet and ability to take risk. If the risk has to be taken by NBFC, then the whole purpose is defeated.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Mr. Kapish Jain, for closing comments.

Kapish Jain: Thank you very much ladies and gentlemen for joining us for our Q2FY23 results call. It was a very interesting discussion with all of you, and for any further query that you wish to have, please reach out to us separately with our investor relations team and we will be happy to connect and solve your queries. Thank you and Happy Diwali to all of you.

Moderator: Thank you. On behalf of IIFL Finance Limited that concludes this conference. Thank you for joining us and you may now disconnect your line.

Kindly note that no unpublished price sensitive information was shared or discussed during the Earnings Conference Call.