IIFL Holdings Limited

Consolidated Financial Results – Q1FY18

Conference Call Transcript

July 24, 2017

Management

Mr. Nirmal Jain – Group Chairman, IIFL Holdings Limited
Mr. R. Venkataraman – Managing Director, IIFL Holdings Limited
Mr. Prabodh Agrawal – Group Chief Financial Officer, IIFL Holdings Limited

Moderator: Ladies and Gentlemen,Welcome to the Conference Call to discuss the Consolidated Financial Results of IIFL Holdings Limited for the Quarter-ended June 30, 2017. 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 the operator by pressing '*' and then '0' on your touchtone phone. I now hand the conference over to the management. Thank you, and over to you sir.

Prabodh Agarwal: Good afternoon everyone, on behalf of team IIFL, I thank all of you for joining us on this call. I am Prabodh Agarwal – Group CFO, accompanied by Nirmal Jain – our Group Chairman, and R. Venkataraman – Managing Director. I now pass the mike to our chairman to share his views on the macro-environment and overview of IIFL group strategy and plans.

Nirmal Jain: Thank you, Prabodh. Good afternoon and welcome to our conference call to discuss the results. First let's discuss the macro-environment, as most of you would know that I am an optimist and have been very bullish on the macro-environment even for a longer-term, say 5 to 10 years, and that is what I have been talking about and writing in various columns off late. In my opinion things never looked as good for India for next 10 years as they do today. Since the previous quarter call, we have seen two mega-reforms being implemented, one is GST and the other is RERA, which is Real Estate Regulations. I think the sentiment even at consumer level is picking up, and not only among investors. I won't talk about the market valuations but if you talk about sentiment then definitely it is looking up and it is getting better. GST has gone lot more smoothly as compared to demonetization because it obviously did not impact everybody. There are small glitches and complaints here and there, but there is a consensus that government revenues will increase very significantly or maybe even multiply, so that obviously augurs well for the resources of the government, the ability to cut taxes and reduce fiscal deficit. Therefore, in the medium to long-term, most of the foreign as well as domestic investors will look at India with a lot of optimism.

Our business is a leverage play on the economy and sentiment, and last quarter has been one of the good quarters, rather one of the best quarters as we have seen tailwinds working for us. As you know that we divide our businesses in three parts. The first is our loans and mortgages, which comprises NBFC and the housing finance subsidiary, now there is a micro-finance subsidiary as well. The second is Wealth and Asset Management, and the third is our Capital Market. I will just speak briefly about the outlook of each business and the strategy there, and subsequently Prabodh will take you through granular details of the results and what we are doing in each of the businesses.

The loans and mortgages or NBFC business has been growing very steadily, if you recall, our strategy has been doubling, durability and de-risking, wherein we have a target to double our income and multiply our profits 2.5 times. There may be a good quarter like this one and people would say that we are resetting our targets, but I think the discussion is not very important at this point in time because we will try to do our best and take one quarter at a time, and of course we know that financial services business can be cyclical. But the more important parts of our strategy are de-risking and durability of earnings, and towards that, in NBFC, our strategy is very simple - retail lending and digital delivery, which also reflects in our decision to get into microfinance. If you look at our incremental loans, significant contribution is coming from small ticket home and SME loans. We have cut down our exposure to large ticket loans. In capital market finance, we have moved to another subsidiary under wealth, and under large ticket construction or developer finance, we are incrementally lending through fund structure which is AIF or Alternate Investment Fund for real estate. Our balance sheet is becoming lot more granular, lot more retail oriented, and lot more geographically diversified as well. The business has grown steadily and actually next three quarters' outlook seems to be improving, and even businesses like commercial vehicle finance which were hit by demonetization are looking up.

In wealth management, we had a record quarter in terms of new money, in fact we had the highest ever collection of new money. You will notice in our presentation that we have given the data for new money and the portfolio appreciation separately, because on our last-base of wealth that we manage and advise, sometimes the numbers can be volatile because of the appreciation or depreciation of the portfolio of clients, so we have tried to be more transparent and disclose separately the amount of new money mobilized and how much is the portfolio variation. There again, we are working very systematically and in a very disciplined manner on making our earnings durable, trying to focus more on advisory and discretionary, trying to make sure that our system processes and client connect are best in class in the world. Wealth business with the new money as well as other organic growth has done very well in last quarter.

The third business is capital market, which many people thought will become insignificant, has performed well too and we are one of the leading players in the industry. In investment banking, over the last 18 months, we emerged as number one in equity issuances i.e. the primary equity issuances, and in fact there is a fairly good pipeline in this business. Over last two decades we have built a strong franchise in capital markets, so one should not have any question about whether we are going to ignore this business, or whether this business is going to be profit-making. This business is also significant for us, but of course over last maybe 10 to 15 years we are seeing that the business has been more volatile, but my personal view is that at least for the next 5 to 10 years, it is looking good in terms of volumes and flow of capital-raising by private companies as well as public sector companies. With this, I hand over to Prabodh now who will take you through the various businesses. Thank you.

Prabodh Agarwal: Thanks Nirmal. We are very pleased to report a 59% YOY growth in our group net profits to Rs. 252 crores for the first quarter FY18, net profits after minority interests have grown by 44% YOY to Rs. 198 crores, our net worth has reached Rs. 4581 crores, ROE was 17.7% and ROA was 2.3%. All the three segments of the company that is NBFC, Wealth, and Capital Markets contributed to this strong growth.

I will now talk about the key developments in the NBFC business. In our NBFC business, loan AUM grew 26% YOY and 5% QOQ to Rs. 23,330 crores. Profit after tax grew by 31% YOY to Rs. 116 crores. The NBFC's net worth is Rs. 3580 crores, our Tier-1 CAR stands at 18.1% and total CAR at 20.6%, thus we are well capitalized to meet our growth requirements for the next 2 to 3 years. Our AUM growth has picked up, driven primarily by small ticket home loans which grew by 82% YOY. The other fast growing segment was small ticket SME loans, AUM growth was flat or negative for LAP, gold and CV segments.

In home loans, our focus remains primarily on the self-employed section which contributes 60% of our home loan portfolio. The fastest growing segment in home loans is the affordable home segment with average ticket size of Rs. 10 to 12 lakhs. We call them Swaraj loans. Incrementally, we are doing more than 10% of our monthly home loan business as Swaraj loans. We are among the top six HFCs in government's Credit Linked Subsidy Scheme or CLSS and our customers have received subsidy of more than Rs. 90 crores so far. We availed NHB refinance of Rs. 150 crores in this quarter taking the total to Rs. 325 crores, which shows the regulator's confidence on our portfolio and mix.

We have crossed 31,000 number of customers in our HFC and target to cross 50,000 by the end of this financial year, which shows granularity of the book. Our average ticket size for home loans is Rs. 22 lakhs. LAP book has seen a slight QOQ decline as our focus is to grow retail home loans. While there has been no material increase in delinquencies in the LAP products, its yield, and therefore, profitability remain under pressure due to competitive reasons. To counter this, we intend to focus on small ticket LAP of below Rs. 50 lakhs and even micro-LAP of up to Rs. 10 lakhs. The latter is being done in partnership with our microfinance company, Samasta. Yields in these products are better than traditional LAP. Our portfolio mix continues to become more granular with greater share of small ticket home loans and SME loans. Increasingly, we are doing larger number of home loans with ticket size of Rs. 10 to 12 lakhs and SME loans with ticket size of about 20 lakhs.

The increasing granularity is driving down portfolio risk while at the same time helps us derive better yield versus large ticket lending. Our relative small size enables us to target this niche segment profitably without being too aggressive in terms of volume growth or pricing. Retail loans including consumer loans and small business finance below Rs. 1 crore constitute nearly 85% of our loan book. Nearly, 25-30% of loan books are PSL compliant, which we can sell down to banks at attractive rates. The share of securitized book stands at 13% of our AUM up from 9% a year back. Our aim is to take the securitized book up to 15 to 20% of our AUM over the next 12 months through higher sell downs of mortgage, retail, CV, SME, and MFI loans. This would positively impact our profitability and CAR. Another target area for us is to disburse more of our home loans through preapproved housing projects. This approach significantly reduces our operating and credit cost and the customer benefits in the form of faster turnaround time, loan approval, and disbursement.

As on June 30, we had over 4500 approved housing projects, up from only 2000 approved projects a year back. Hundred percent of our construction finance loans and 55% of home loans are made through these approved projects. Our average cost of borrowing declined by 20 basis points QOQ and 140 basis points YOY to 8.6%. Incrementally, we are now borrowing at an average cost of 8.2% as the cost of borrowing especially term loan from banks collapsed over the last 8 to 9 months. Both availability and cost of funding have significantly improved. We are now borrowing from banks at their MCLR. In the current environment of risk averseness and low-credit growth, banks remained very keen to lend to us and buy securitized pool from us. Our NIM was at 6.6%, up 50 basis points YOY and down 21 basis points QOQ. Declining borrowing costs has helped expand NIMs which is partly offset by the changing AUM mix towards lower yielding retail home loans. Going forward, continued fall in our funding cost and stronger growth in some high yielding products like SME and gold should support our NIMs.

Cost-to-income ratio was at 39%, down 370 basis points YOY and flat QOQ. Going ahead, we believe there is significant scope for the cost-to-income ratio to fall due to better economies of scale across our products and benefits of digitization. NBFC headcount grew 5% YOY to about 7800 and the number of NBFC branches has remained almost unchanged at 1114. In this quarter, we moved to 90-day period NPA recognition norm, our GNPAs were at 2.04% and NNPAs were at 0.94% up from 1.82% and 0.58% respectively in fourth quarter FY17. The sequential increase in NPAs was largely in the CV segment where the industry is still going through a slowdown in volume growth and collections. The payment cycle from bank operator has gotten longer post demonetization and the move to 90 DPD NPA recognition norm led to some increase in delinquencies. NPA ratios were stable across most other segments.

Talking about digitization, in first quarter we are focused on increasing usage and penetration of existing digital capabilities. 100% of gold loan, 77% of CV loan, 26% of HFC loans, and 71% of SME loans were booked in the digital mode in June 2017. Additionally, our E-KYC service usage is now increasing steadily with 99% of gold loans, 30% of CV and SME customers now getting booked on E-KYC platform, 14% of all gold loans booked in June '17 were through E-Sign thereby completing the entire transaction in digital mode. E-Sign helps in our effort to contribute towards environment by saving paper or trees. As per our estimates, we have saved paper equivalent to six trees in the month of June 17 itself. This is based on calculation from website, treehouse.i.hmc.co.uk. We have also launched UPI-based collection on our mobile app to allow seamless and real-time payments into the loan account.

In analytics, there is a strong focus on maximizing the use of data and analytics to drive business decisions. Cross sell to existing customers is a great opportunity and we have started making steady inroads. For example, 30% of our digital personal loans disbursed in the previous quarter came from existing customer databases. At the same time, we continue to strengthen our risk analytics capabilities and incorporate scorecards into the digital on-boarding mechanism for core retail products.

Now, let me take you through some key developments of the wealth business:

IIFL Wealth PAT grew by 64% YOY to Rs. 86 crores. Our assets under advice, management and distribution have grown 60% YOY and 17% QOQ to reach Rs. 1.26 trillion. In this quarter, we have provided some additional disclosure, as Nirmal mentioned, on our wealth business. Firstly, we have reclassified the assets into five categories and removed few assets which were being double counted, for example, some AMC assets and NBFC assets which were also included in the distribution assets. Secondly, we have provided breakup of our retention yield into fee-based and fund-based yield. Thirdly, we have provided details of our AUM movement during the quarter that is net new money garnered, growth due to market performance, and change due to exchange rate fluctuations. Fourthly, we have provided the profit and loss account of wealth business in a new format that will make it easier for you to understand. These additional disclosures are being made based on suggestions and feedback from many of you.

Last quarter was an exceptionally strong quarter for us in terms of new money garnered, we raised Rs. 11,250 crores in net new money which is 50% of the net new money garnered in the whole of FY17. During the quarter, the team garnered AUM in wide-ranging products including focused equity AIF, debt and equity mutual fund products exclusive to IIFL clients, and standard mutual fund products. In our AMC, we raised Rs. 4000 crores in special opportunity fund to invest in pre-IPO and IPO situations. AIF assets have grown 67% YOY to more than Rs. 8300 crores.

IIFL Wealth Finance which offers loan against securities and margin funding to high net worth clientele grew its loan book 19% QOQ and three fold YOY to Rs. 4305 crores. Average lending rate for this book is around 10.5%.

We hired 27 RMs during the quarter to further drive the growth momentum. IIFL Wealth offers a broad range of products and services to participate in a large share of the client wallet. This includes family office, trusts, AIF, estate planning, offshore advisory services, brokerage, NBFC and research.

Finally, let me take you through key points on the capital market. During the quarter, our average daily cash turnover was up 34% YOY to Rs. 1112 crores. Our average daily total turnover was up 53% YOY to Rs. 11,063 crores. We are continuously enhancing our offerings on digital and mobile platforms for retail customers in our broking business. Our mobile trading app, IIFL Markets, has had over 1 million downloads, and presently about 36% of retail broking clients trade through the mobile app. IIFL is ranked number one investment banker in equity issuances from January 1, 2016, to June 30, 2017. The investment banking team completed three transactions during the quarter including QIPs of SBI and Federal bank and IPO of IRB InvIT fund. The pipeline of IB deals is robust. With that now, we will open the floor for Q&A.

Moderator: Thank you. Ladies and Gentlemen, we will now begin the question and answer session. We will take the first question from the line of Pavan Ahluwalia from Laburnum Capital. Please go ahead.

Pavan Ahluwalia: I appreciate the effort to show greater transparency in the presentation especially on the wealth management front, I am still struggling with how to really look at the potential for growth and wealth management and as we discussed in previous con calls, the crude metrics of revenue margins on assets do not really seem to work, so could you give us some sense of how you are holding the wealth management team accountable, how you think about targets, what are the metrics that we really should be cracking or is it just that we have because you could see a situation where your assets do not grow, but you manage to push much more profitable products through the client pipeline and you manage to grow early, so it is not clear to me how we should be thinking about growth in the wealth management vertical, so would love to get a little more clarity on that. Also one suggestion, could we have the wealth management leadership team on the call because it would be very helpful to be able to get their take on this as well and as the business grows and becomes a bigger portion of equity value, it would be very helpful to get their take. The second question I have is on the MFI side, now you sound quite positive on the prospect there, the data that we see coming out of several listed MFIs as well as on the ground report whether it is in the press or industry evidence suggest that there are serious question of credit quality when it concerns MFIs, how are you trying to address this as you extend credit in this area?

Nirmal Jain: First question is wealth, my simple answer would be that one has to look at the new money coming in and that is why in fact we have given the data for the first time. There will be a key driver for a growing business or in a growing country like ours, but once you reach a mature stage then you try and cut down on your expenses to improve the profitability or margin. But pushing high margin products to the same set of clients is not a sustainable model and that is not how we reward or incentivize our people. What happens with new money is that most of the time it comes from new products and there will be some bit of upfront income and commission on that, so that basically will be the driver. I don’t know whether that clarifies your question, but internally, to keep things simple, for a country like India and businesses like ours in wealth, new money is the core driver. Secondly, the mix of the money in discretionary or our own advisory platform, if you move, then it becomes a longer-term more sticky and controllable part of assets. We should have a healthy mix there. If you would have seen the chart, the distribution, brokerage and all other assets have come down from 86% to 75%, maybe we can bring them down to say 60 or 50 over a period of time, so that will be an another healthy trend for the business.

Secondly about MFI, you are right, there are questions about credit quality of some of the MFI companies, but at least in our minds we do not have any doubt about the business model and the longevity of business model because MFIs go to the bottom of the pyramid and that is where India is rising. Earlier, from outside even we were skeptical but as we have seen this business for more than a year now, if you do it well, do not go overboard and do not try to over-lend, typically like you lend Rs. 15,000 to Rs. 25,000 but to the same customers if you go aggressive and say I am going to give you a lakh rupees, obviously there will be problems. I mean in any credit business for that matter if you keep steady pace and your processes are focused on retail, and therefore, the process becomes more important for us and not a personal call or a view. We have been seeing that there are other companies that have gone very aggressive and gone into difficulty, but as a business model that can happen in any business. Even in housing finance business, where everybody is euphoric now, you can run into credit problems if you are indiscreet or you do not follow the process or do not have the right kind of people. But having said that, from a long-term perspective, MFI is a good business. Also this business has one more risk which is local political problems, for example, after demonetization, areas of Karnataka and UP had difficulty in collection because the local political leaders announced that the loans will be waived off. There are two strategic approaches to dealing with this: one is that we are going to geographically diversify and not be highly concentrated in one local area; and two, not only we but many other microfinance companies are educating farmers that their CIBIL score or credit score matters from a long-term credit point of view, that by defaulting loans short-term what will happen is that nobody will give them credit for the rest of their life and many people I think are understanding this.

Moderator: Thank you. The next question is from the line of Viral Shah from Credit Suisse. Please go ahead.

Viral Shah: Partly my question was answered in the previous one on the MFI segment, so in terms of the business that you have, the acquired business, any idea you can give in terms of the profile, what geographies they are in currently and where you expect them to expand and what kind of model that they follow weekly, monthly, etc., that will be very helpful?

R. Venkataraman: As you know we have taken a majority stake in the company called Samasta Microfinance, Samasta Microfinance is headquartered in Bangalore and it is promoted by gentlemen called Venkatesh who has many years of experience in the MFI business. As we speak, the assets under advice amount to about Rs 284 crores. We have about 75 branches which are primarily located in the states of Karnataka, Tamil Nadu, Maharashtra, and Goa. As Nirmal spoke about it, the Karnataka portfolio was affected by demonetization of November 8, and subsequently in the last six months, significant efforts have been made on the recovery front of it. We have spent a lot of time and energy educating all the customers about the ill effects of delinquency and how it affects the CIBIL score and on incremental basis, the portfolio quality is showing significant improvement and things are coming slowly and steadily to normalcy in the other three states, which is Tamil Nadu, Maharashtra, and Goa. Karnataka still we are having problems though we are hopeful that things will improve. As of now, we have a monthly collection mechanism in Samasta. Whether we do daily, weekly, fortnightly, or monthly, it is a trade-off between operating cost and collection efficiency. As of now, we are doing monthly collections but to address your point, in the problem centers and problem branches especially in Karnataka, we have reduced the collection cycle from monthly to fortnightly and weekly.

Nirmal Jain: One small point on Pavan's previous point that we should get wealth senior management also on the call, in fact if we do that then you obviously have to get the management of NBFC, HFC, and may be microfinance also now as well as capital market and investment banking also, so may be Prabodh can think it over and try at least once in a year.

Viral Shah: I had one more question, slide #18 where you have the yield for the wealth management business, so thank you for spreading out the fee and fund-based activities income, so the fee-based income that seems to be coming down, how should we see that going forward, of course you are getting a kicker from the fund-based activity, but on the fee-based segment how should we see that going forward, it has been coming down?

Nirmal Jain: From quarter to quarter, few basis points it can go up or down so from 72 to 69 basis point is what the drop is, but that kind of variation I do not think one should worry too much about, because it will remain in that range. When we are launching a new fund and that is what is collecting money, income might get booked as a fund-based commission or fund-based fees, but I think it will remain in this range and the important thing from our point of view will be also to bring down the operating cost because as competition increases, there can be some pressure on the fee-based income or what we charge, but 2 to 3 basis points, I would not read too much into it. Lot of things get charged in the last quarter also actually, so the previous quarter was the last quarter of the Financial Year where you might have tendency to have few basis points more.

Viral Shah: The last question is on the same slide, the segment wise classification of the AUA, is it just re-naming or has that been stuff which have been moved around?

Nirmal Jain: There are lot of changes in that because what we have done is we have removed the custody asset out of this and we have broken up the assets, so earlier if you remember, that was more into investment manager. What we have done now is that we have clubbed the asset management and PMS because that is also becoming significant now and off-shore assets we have divided them in two parts which is FPI, which is institutional money where we won't earn much and the discretionary assets where they are coming into our AMC, so there is lot more data in this.

Viral Shah: Back in the NBFC segment, basically you mentioned about home loan and SMEs, this has been the focus areas, any geographical color that you could give on these two segments?

Nirmal Jain: We are geographically fairly well-balanced, so if you look at our geographical split then East will account for lesser maybe around 12% or so, but then again East is a smaller economy as well, but otherwise West is 35, South is 35, and North is 18. North is little lesser than what it can be, but more or less we are fairly dispersed and distributed through 1100 branches all over the country. This will be more proportionate to the size of the economy in the various zones, so if you really look at it like West with Maharashtra and Gujarat, and South also four states, the economy is also larger and they have larger credit absorption capacity as well.

Viral Shah: Just to confirm, all your construction finance is now happening through the AIF?

Nirmal Jain: No, what we are doing is that from the HFC we are doing smaller ticket construction finance which are typically 10 to 15 crores which dovetails into our home loan business because we get preferred access. So if you look at our average ticket size of home loan has come down to Rs. 22 lakh and incrementally there is focus on 10 lakh also. There are quite a few smaller towns, so what we do is that where we find the project is good, the approvals are in place and the builder is good, we finance the project and that becomes an approved project for financing, so we get a preferred access to home buyers there for financing. Earlier the large ticket home loans of the construction project were there, but now the focus in construction would be on the smaller ticket.

Viral Shah: I thought I read in your presentation that you are doing some construction finance through the AIF?

Nirmal Jain: We are doing the larger projects, typically the projects which are in Mumbai or big ticket 200, 300, 500 crores projects, that we try and do through a fund structure or placement of debentures, but as far as our balance sheet is of concern, our focus is more on projects where we can get access to home loan which is our core business. Housing finance company will have a portfolio from 30% which is construction finance and LAP.

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

Ashwin Balasubramanian: I have a couple of questions, firstly if I look at your consolidated IIFL Holdings results, the provision number of 143 crores whether it is IIFL finances provision number is about 71 crores, so if you can provide some color on where the remaining 70 crores provision would be, that is question number one, and also this provision number has actually inched up over the past 2 to 3 quarters, any color as to why the credit cost has remained somewhat elevated in the past two quarters?

Nirmal Jain: The provision is there for sundry balances, capital market, NBFC, HFC, all put together and since this is a good quarter, we were a little more aggressive in providing and just cleaning up the balance sheet.

Ashwin Balasubramanian: This remaining 70 crore would largely be in the wealth finance subsidiary or?

Nirmal Jain: Yes, in the capital market, wealth, and sundry accounts in other companies as well, so as I said that will be consolidated for all businesses including housing finance, HFC, microfinance, and capital market also.

Prabodh Agarwal: Can I just add to that, These provisions that you are referring to at IIFL group level, these are not just provision for loan losses, these are provision for other expenses as well. There is no separate provision for loan losses which is given at the IIFL group level. That provision at the group level has been clubbed under administration and other expenses, that other expenses include the provision charges also.

Ashwin Balasubramanian: In terms of LAP, you mentioned that you are facing yield pressure, so what would be the incremental yields for you in LAP?

Nirmal Jain: These are all 15% in the smaller ticket LAP, but if you look at the traditional LAP then the competition has got the rate down to almost 9%, 10%, 11% kind of thing, but if you look at, 5, 10, and Rs. 50 lakh LAP, then it can be 14 to 15%.

Ashwin Balasubramanian: Going forward, this 12.9 which you have reported in slide number #21 that would roughly be kind of blended yields since you are moving more into smaller ticket?

Nirmal Jain: There are two ways the pressure is working, the existing LAP which is large ticket and good, then there is a pressure to bring down the rate, otherwise, competition is offering very low rate. You would have seen that the percentage in the overall portfolio has come down, but I do not think yield will improve significantly, it will remain under pressure, but that is more than made up by the reduction in cost of funds.

Moderator: Thank you. The next question is from the line of Vikas Garg from L&T Mutual Fund. Please go ahead.

Vikas Garg: Thanks for the very detailed response that you had given on the MFI books that was quite helpful. I have couple of queries on other part of the book, first on the wealth management NBFC where the growth has been quite significant and we have already closing to 45 and 100 crores kind of a book, so what is the nature of that book in terms of granularity across the customers and also possibly the kind of cover that we have on that book and what kind of a growth do you expect over there? And a little bit more color on the MSME would be very helpful given that they are on the lower ticket size maybe Rs. 20 to Rs. 25 lakh of ticket over there, so how prepared are those smaller MSMEs in the GST to be able to transition to a more formal way of economy?

Nirmal Jain: First is wealth NBFC, if you look at our assets and the size of the NBFC book then it is just about less than 4% and globally also most of the wealth managers, the funded book will be significantly higher maybe around 20 to 30% at least, so this book can grow steadily and the color of these kind of loans, they are typically our wealth customers and why they need to borrow is that they need to borrow for tax, they need to borrow for short-term opportunities sometimes if they are doing their tax planning based on bonus and division opportunities then they need to borrow, but most of these loans are short-term loans. Typically, we do not provide promoter funding, so this NBFC is very integral part of wealth, it is not pure play NBFC which we look at all kind of businesses and all kind of opportunities. If you look at the average rate of interest of west zone is around 10% to 10.25%, it is not really trying to maximize NIM and ROA there, but it is trying to be subservient and supportive of wealth business.

Vikas Garg: On this question of wealth management only, would we also be doing real estate financing over there as part of environment of any HNI?

Nirmal Jain: No, we will not do real estate financing over there, but suppose a wealth customer is buying a home or property, typically there also our loan will be more like a bridge loan. If we have got enough asset cover, if you look at the asset cover or the wealth that we manage for the same client, it will be a very significant cushion always.

Vikas Garg: Can we easily assume that the LTV that you maintain on your capital market book is around 55%, so possibly a similar LTV is also applicable on the wealth management book?

Nirmal Jain: In the NBFC you cannot lend more than 50% as per RBI regulations, so we will maintain the same thing.

Vikas Garg: On the MSME front, how would you…?

Nirmal Jain: Under MSME, for the small ticket loans, we have digitized the process and created an automated credit scorecard. In fact three years ago we worked with Mckinsey to work on this and they developed the first model which has evolved over a period of time, so this business can scale up very well. The idea here is that insta-loan, which is less than Rs. 10 lakh of loan, we do the geographical mapping of the entire country, so we pick up areas where shopkeepers or small businesses should be doing good business then we have our own database of their margins and their potential, so you go and ask customers a few questions on a tablet which our sales executives carry and if they want they can connect on the tablet to the central office for a video conversation if need be and based on those questions, the loan is instantly approved or disapproved and most of the paperwork is also digital through Aadhar and E-KYC, so this is the business that we have been working on and I think this business is growing well. Typically our sweet spot is less than Rs. 50 lakh, again broken into two parts, less than Rs. 10 lakh automatically instant which we can give immediate approval across the table and Rs. 10 to Rs. 50 lakh is also another loan, which is also quick turnaround time and that is our focus.

Vikas Garg: That is very helpful, actually my question was on the preparedness of these smaller ticket sized MSME on the GST framework, prepare to transition themselves into a more…?

Nirmal Jain: I think what will happen with GST, first of all it is too early to comment on this because as of now we have not seen any stress or any problem. Some of the businesses may come under the Rs. 75 lakh turnover limit, where you can just pay 1% tax and you do not have to maintain anything, for less than Rs. 20 lakh of turnover you are not required to get GST registration also, so people are still catching up. I do not think there is undue worry or problems as everybody has got Tally, or Chartered Accountants or somebody to help. Any issues we will know after the first few returns are filed because there are three returns to be filed every month, this is still the first month, maybe by July/August end, after two months only we will know because the first two months the government has also given leeway time for filing returns. But from medium-term perspective, this will be very good, because what will happen is that a lot of tax evasion which was happening by not disclosing turnover, will stop. Under GST, because of the completely integrated approach, everything can be very well monitored. So a lot of tax evasion will go. What it does is it brings into official records, the actual data about turnover and the potential. In a way, many MSMEs will be qualified for credit now. I think over medium term, this will bring lot of discipline and lot of good culture within these MSMEs, but it is too early at this point of time.

Vikas Garg: During this transition period, you possibly see this as a good opportunity for us to be able to scale up more of MSME segment and create a strong network over there?

Nirmal Jain: I think you are right, there is a great opportunity and we are just watching it, may be as I said that after couple of months when the returns have been filed, that leeway is over, then we will know how they are coping up, but I would say that there is a great opportunity to build this model of B2B with the GST in place now.

Vikas Garg: One more last question if the time permits, on the AIF book which you were indicating, so that would be sitting under wealth management, your discretionary part of portfolio?

Nirmal Jain: Yes, that is right. For the real estate project, we have raised more than billion dollars for real estate, but another billion dollar for non-real estate funds also, sometimes NBFC also acts as a sponsor, so NBFC will have the responsibility to do the credit appraisal and collection and there will be small fee for that, but there will also be co-investment in some projects.

Vikas Garg: From the credit risk perspective?

Nirmal Jain: All entire asset management sits under wealth.

Vikas Garg: It would be more of a pass-through to the possible investors who would be investing into those AIF funds?

Nirmal Jain: Depending on the size of the investor, the deal is structured.

Vikas Garg: All put together, what could be the kind of seed money that we as a NBFC or any other platform under IIFL group that we would have provided to these AIF?

Nirmal Jain: 5 to 10%.

Vikas Garg: In absolute terms, it would be how much?

Nirmal Jain: It will not be very significant actually and it will be very small part of the portfolio, less than 1% of our loan book kind of thing on the aggregate.

Vikas Garg: Maybe around couple of 100 crores?

Nirmal Jain: 200 or 300 maybe around that much, I wouldn't know the precise number, but it is not very large.

Moderator: Thank you. The next question is from the line of Ashish Kumar from Infinity Alternatives. Please go ahead.

Ashish Kumar: I was just wondering now that the retail NBFC businesses has kind of stabilized, if there is a guidance you want to give us in terms of what would the credit cost for the full year?

Nirmal Jain: If you look at our GNPA on a like-to-like basis, it would have fallen by almost around 25 to 30 basis points in this quarter, so we are now at 2.04% GNPA with 90 days recognition which was 120 days till last quarter, credit cost whatever we have been providing in the last two quarters we had stepped up our provision and credit losses, so it will remain similar. I do not think there will be any significant change there.

Prabodh Agarwal: Just to add to Nirmal's point, our credit charge has been around 130 odd basis points as a percentage of average loans. Now that has gone up slightly because of the provision that we made on CV loans and some of the LAP loans etc., now going forward because our focus is on home loans where the delinquencies will be lower and on the other hand, the unsecured SME book would be growing where the credit charges could be higher, but net-net we think the credit charges should remain in that 120 to 150 basis point range.

Nirmal Jain: Last quarter it was 135 basis points compared to 121 in the quarter before, so I think between 130 to 150 on the higher side that is what we can presume.

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

Nishchint Chawathe: Thank you very much for the disclosure on the wealth side, just wanted to check what has driven high capital market income in the first quarter, if I look at the growth in your volumes, I guess that is much lower than the income growth, so can we assume that the Delta comes in from investment banking?

Nirmal Jain: Yes, that is right and for some of the transactions of the previous quarter, we get revenue in this quarter, so I think delta has come primarily from investment banking.

Nishchint Chawathe: On the CDC conversion when are we expecting that?

Nirmal Jain: CDC conversion can happen in 3 to 5 years because that will not make much of a difference. The arrangement with CDC is that in rupee terms if they are getting 8% then conversion will happen without any dividend at the rate which was at 0.01% dividend, which is negligible. I think that will happen sometime between 3 to 5 years, so we have completed one year. The conversion will be more of a formality because the price and terms are already preset.

Nishchint Chawathe: It will lead to some dilution, because currently you are taking 100% kind of consolidation?

Nirmal Jain: No, in our consolidation we are diluting by 15.45%, so when you look at NBFC number standalone then we will consolidate with NBFC subsidiaries, but when you look at our parent consolidation then we are knocking of 15% of NBFC in that.

Nishchint Chawathe: Today, it is 99%?

Nirmal Jain: No, our equity is, the way we take it is 85% because any instrument which is compulsorily convertible is also equity, Prabodh, am I right?

Prabodh Agarwal: Yes, the thing is that, Nischint, we are fully diluting, we are taking that CCPS as our equity so that reflects in our equity share capital as well as reserves and for the calculation of our ROE, its fully diluted, there will be no change, there will be no accounting change, it is just that CCPS will get converted but for all accounting, there is no change at all.

Nishchint Chawathe: Just on the wealth side, now I believe you have entity called IIFL Asset Management Mauritius, is this the AIF?

Nirmal Jain: No, this is an asset management company.

Nishchint Chawathe: It is an AMC, so the income that we see around 60 crores or something is actually the AMC income?

Nirmal Jain: IIFL Wealth Mauritius income you are saying?

Nishchint Chawathe: This company is IIFL Asset Management Mauritius and its income last year was around 66 odd crores?

Nirmal Jain: 21% of our assets are overseas assets and part of that are also our institutional clients and FPIs so that income is booked there.

Nishchint Chawathe: This will essentially be asset management income, not really distribution or anything of that sort?

Nirmal Jain: Primarily asset management or advisory.

Nishchint Chawathe: Finally on the NBFC side, what is the dividend policy?

Nirmal Jain: NBFC side, dividend will not reduce but will not increase also because we will reinvest the money, so we will keep it constant at whatever rate or maybe a very nominal increase or maybe we will keep it as it was last year. The dividend policy is that we can go up to 30 to 35% but after taking into account the requirement for the business, so NBFC requires capital to grow, but at the same time, we do not want to have dividend per share as a trend to fall, so we will keep it constant.

Nishchint Chawathe: Finally, just one bookkeeping question, any change in the fully diluted shares of IIFL, the parent company?

Nirmal Jain: No, there may be some ESOP exercise, but that will not be significant but other than that nothing.

Prabodh Agarwal: Nischint, the weighted average number of shares is 31.79 crores and the fully diluted number of shares is actually 32 crores, 31.99. Last quarter, it was 31.79, there is 0.2 change because of ESOP conversion.

Moderator: Thank you. The next question is from the line of Dhaval Gada from Sundaram Mutual Fund. Please go ahead.

Dhaval Gada: Most of the questions have been answered, so just two data points, one what would be the average duration of the loan book in the wealth piece, and second, if you could provide the write-offs in the NBFC book?

Nirmal Jain: Typically, one year.

Dhaval Gada: The second was the write-offs that you have done during the quarter in the NBFC?

Nirmal Jain: The loan losses are given, there is a Rs. 75 crores of write-offs and provisions in aggregate.

Prabodh Agarwal: We have taken write-offs of around 55 crores in the quarter.

Dhaval Gada: Would you have the number of last quarter, 4Q FY17?

Prabodh Agarwal: Write-off last quarter was a very small amount would be about 10 to 12 crores.

Moderator: Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Funds. Please go ahead.

Amit Premchandani: Just on the wealth management part, can you give us indicative retention yields of different asset classes in terms of equity, fixed income, and alternative investments?

Nirmal Jain: That will be very difficult actually because many times it works on a portfolio basis.

Amit Premchandani: Sir, in terms of discretionary offshore, the share has gone down while distribution share has gone up, if you can indicate whether that would lead to an increase or decline in yields?

Nirmal Jain: This is not very easy to answer again, but at this point in time the money that we make from distribution assets may be few basis points more than the discretionary, but discretionary is more sustainable and long-term, but there is no significant difference in the yield on the two, when we look at the aggregate pool of assets in discretionary and distribution.

Amit Premchandani: Sir, what is the philosophy of management in terms of thinking about listing of this wealth management services?

Nirmal Jain: At this point in time it is not on the cards, but maybe, as we had said earlier also, in next 3 to 5 years, we will look at it at an appropriate time.

Moderator: Thank you. We will take the next question from the line of Jahnvi Goradia from Motilal Oswal Asset Management. Please go ahead.

Jahnvi Goradia: Sir, my question is mainly pertaining to the construction in real estate piece, while that book was flattish last year this quarter on quarter it has grown by 15%, so just wanted to understand pre-RERA what kind of activity have we seen in this book, and secondly, also on the outlook on this book because now we are hearing that builders are postponing and going slow on new launches, so while housing finance remains attractive from a longer-term point of view, from a shorter term say six months to one year perspective, how do you see new launches and housing finance as a market?

Nirmal Jain: The growth in book is primarily in the smaller construction loan through our HFC, and secondly, you know the market I think from a longer-term, we are long-term players so there can be small cyclical variations, but this worry what you are talking about of slowing down is more in the larger city and high ticket home loan, but otherwise I think things are quite okay, they are not as good as they could be, but they are looking up in the housing market and the future for medium to long-term is looking very good and RERA also will help. The initial feedback that we are getting is very good because now most of the home units will be bought by home users, the end-users and not investors or speculators, and also a lot of discipline will come in terms of how builders use the money and construct the project. From middle term perspective, that also is very good for this business.

Jahnvi Goradia: I understand the luxury market we all know has been dull since quite some time and it is the affordable that is picking up, but you mentioned earlier that affordable disbursements are about little more than 10%?

Nirmal Jain: No, within affordable, there is the Swaraj loan which is a very small ticket, which is Rs. 10 lakh which are more like micro-loans, but if you look at our entire home loan portfolio is more or less affordable only, but within that the Rs. 10 lakh is a very, very small amount that works only in very small units, that also is growing and that has become more than 10% of the portfolio, but other than that if you look at our home loans then it is entirely affordable.

Prabodh Agarwal: Jahnvi, your question on Swaraj, that is part of home loans, so as we mentioned that Swaraj is incrementally 10% of our home loan book. What you initially asked was on construction and real estate, now in construction and real estate the 28% YOY growth that we see, is almost entirely driven by construction finance -which is what Nirmal referred to, and construction finance dovetails with our retail home loan strategy with average ticket size of between 8 to 10 crores. That portfolio has grown 52% YOY so that is what is driving this 28% YOY growth in the overall construction real estate book.

Jahnvi Goradia: Sir, how is the market which is not very affordable, not 25-30 lakhs but say one crore house loan to say 3-4 crores if I am talking about Mumbai, that is not even luxury and is not even affordable, but it is quite a considerable piece of the housing market, so how is that market shaping up?

Nirmal Jain: That market is mostly serviced by banks actually and there also sales have slowed down.

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

Prabodh Agarwal: Thank you everybody for joining us on this Analyst Call today. If you have any further questions or follow-up, please feel free to reach out to us or our Investor Relations Department. Thank you so much and have a nice day.

Moderator: Thank you. Ladies and Gentlemen, with that we conclude today’s conference. Thank you for joining us and you may now disconnect your lines.