“IndoStar Capital Finance Limited
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Moderator: Good day ladies and gentlemen, and a warm welcome to the IndoStar Capital Finance Q1 FY2020 Earnings Conference Call, hosted by Motilal Oswal Financial Services. 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. Piran Engineer from Motilal Oswal Financial Services. Thank you and over to you Sir!

Piran Engineer: Thanks Ali. Thank you all for joining this call with us. We have the entire management team of IndoStar Capital to discuss the results. Over to you Sir!

R. Sridhar: Good afternoon to all of you. Let me first give an overview of Q1 in terms of our performance. This quarter is significant as this is the first quarter subsequent to the acquisition of the commercial vehicle finance business from India Infoline. We have as you are all aware, acquired the CV financing business which consists of around 161 branches, 1089 people and Rs.3400 Crores of AUM. We are currently undertaking a process of integration which we hope to complete in the next two to three months. We have absorbed the entire team, which is complementary to what we have already built. We now have a pan India presence across all the main zones in the country North, South and West where our presence spans 322 locations with around 2000 people manning these branches. This acquisition has saved us nearly two years of effort to create the network organically. While, we have grown our capacity to service demand, liquidity environment for NBFCs has been challenging. To ensure that we optimally utilize our infrastructure, we embarked on a partnership agreement to de risk resource raising. In this pursuit, we have finalized a partnership deal with ICICI bank enabling them to lend to our CV financing customers by piggybacking on our business infrastructure. We will discuss this in detail during the course of the question and answer.

Thus, the two most important things that transpired during this quarter is (i) the integration of the business which we had acquired from India Infoline and (ii) the partnership with ICICI Bank. Both these events will help IndoStar to continue pursuing growth in CV finance and make it the engine for our retailization strategy. The retailization strategy, which we started about two years back in April 2017, is on track and now at the end of this quarter, our retail assets are at 63% versus corporate assets at 37%. We have ensured that the corporate book has not grown in the last three years and it has been around Rs 4000- 4500 crores. The growth in CV financing in the retail business as well as the acquisition has helped us change this mix drastically. In terms of business, disbursements during the quarter have been around Rs.1,235 Crores. Retail business volumes were broadly similar to Q4 while corporate lending disbursements were around Rs.470-odd Crores. We have been cautious in lending under this segment because of the market conditions. In this backdrop, I believe our current level of disbursements - Rs.1235 Crores is good. Our aggregate assets under management (AUM) is around Rs.11000 Crores. On-book loans are around Rs.10000 crores.

The quality of our assets continues to be good; We have one account in corporate lending, that slipped during the quarter which drove the provisioning higher. Further, while examining the loan portfolio acquired from IIFL, we had found certain accounts where collections were not up to the mark for a protracted period. After a thorough examination, we took a decision to clean up these accounts and accordingly effected a write-off of around Rs.60 Crores during this quarter.

The business is broadly moving as planned though liquidity has been the only constraint during the past couple of quarters. We have proactively taken a step to forge a tie-up with ICICI Bank, which would help us in keeping our disbursement objective intact and we hope that we would be able to report a good growth in terms of disbursements and assets during this financial year.

In terms of SME business, we have been doing well. Liquidity constraints have been the main factor causing a slowdown in the volume of disbursements. As against about Rs.100 Crores check and Rs.125 Crores which we averaged for a large part of FY19, we are currently disbursing around Rs.50 Crores now. We are in discussions with few banks and hope to be able to ink a partnership similar to the one in CV finance over the next couple of months.

The business in affordable housing finance is doing very well. We are doing around Rs.30-40 Crores per month at a yield of around 14%. The quality of this book is very good. The NPL is negligible and all accounts are current. Like we have stated earlier, had liquidity not been a challenge, we could have clocked superior volumes in this business as well. That said in light of the uncertain market dynamics, we are adopting a cautious approach to calibrating growth.

So, with this overview, I now leave the floor open for questions and answers. I have with me my colleagues, Mr. Amol Joshi, CFO designate, Mr. Pankaj Thapar, CFO, Mr. Shailesh Shirali Corporate Lending Head, Mr. Prashant Joshi, Chief Operating & Risk Officer and Rajagopal, IR Head who would be happy to answer your questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Jayprakash Toshniwal from India First Life Insurance. Please go ahead.

Jayprakash T: First question on ICICI partnership. Is it for any particular product line, new or used?

R. Sridhar: ICICI partnership is for the CV Finance business which includes both new and used vehicle consumers. Based on our current yield and portfolio blend, we should be getting a spread of about 5-6% under this arrangement. The entire loan will be disbursed by ICICI Bank and we will be providing a first loss default guarantee of 8%. This is a superior arrangement as it reduces the capital requirement which would have been higher (around 15%) had we chosen to book loans on our Balance Sheet. Here the spread is protected at 6% and in light of the capital light structure helps improve ROEs.

Jayprakash T: Will there be a differentiation in the quality or yield of the portfolio being originated for ICICI versus originating loans for your Balance Sheet.

R. Sridhar: No. There won't be any differentiation in the quality or yield of the loans that would be originated from our branches. Spread and the blend will remain the same at 6%. As I explained earlier, for loans being disbursed by ICICI Bank, the capital requirement for IndoStar reduces to the extent of capital prescribed to be held on the first loss default. Had we retained the loans on our Balance Sheet, we would have to maintain capital at 15%.

Jayprakash T: Okay and second Sir there was news around a specific corporate account in the Fitness industry that was being rumored of having servicing issues. Could you throw some light on that?

R. Sridhar: The account that you are referring to has not slipped in servicing dues to us. They have met their servicing obligations for the month of July as well. Only one account in real estate segment has slipped during this quarter for which we have made a provision. All other accounts are current.

Jayprakash T: Okay Sir a final question. In light of the concerns around the account mentioned earlier, can you elaborate any change in your strategy in corporate lending to potentially deal with such idiosyncratic risks?

Shailesh Shirali: What we have done over the last one year is that because the liquidity situation in the market had deteriorated owing to Banks and NBFCs pruning lines to SMEs, mid cap and small cap companies, largely non-real estate clients we scaled down our exposures. The non-real estate book actually has come down from a level of more than Rs.2,600 Crores to now below Rs.1000 Crores as of July and we are treading with caution on this book. We are adopting a wait and watch strategy. There is a very decent pipeline if we want to lend but we do not want to start lending in any manner until the liquidity situation in the market improves. So, if you see our overall book also, the overall corporate lending book real estate plus non-real estate in last July we were close to around Rs.5,300 Crores in this July we are down to Rs.4000 Crores. We started the retailization strategy about 18 months back and then the IIFL CV finance acquisition happened. Taking the two together, we have enough room for capital allocation across all our four product lines. So, given the liquidity issues in the market, we have decided consciously to go slow on corporate lending, evaluate proposals very selectively, just focus on asset quality and recovery and we have brought down the book from around Rs.5500 Crores to Rs.4000 Crores until the market improves, we will continue to do that. We will continue to basically just churn the book and book assets within this range itself and not look at any kind of aggressive growth.

Jayprakash T: Okay Sir. I will come back in the queue. Thank you.

Moderator Thank you. The next question is from the line of Akash Dattani from HDFC Securities. Please go ahead.

Akash Dattani: Thank you for taking my questions. I have couple of them. My first question is on treasury assets in the presentation, there is a sharp Q-o-Q decline. Is that because of the payment to IIFL for the acquired business?

R. Sridhar: Reduction in treasury assets is largely a function of consumption driven by various businesses. IIFL payments are staggered over a 12-month period. Hence, it is not appropriate to purely identify reduction in treasury surplus to purely IIFL payments.

Akash Dattani: Okay and so in terms of the write-off taken this quarter on the acquired vehicle finance book, so how would the backstop or the arrangement with IIFL you would sort of play out?

Prashant Joshi: If you look at the write off, the total write off that we have taken is Rs.64 Crores, of which Rs.50 Crores is the one-time special write off that we have taken and Rs.14 Crores in the normal course of business through settlements and repossession and sale that we do. Actually, we had over provided even while making the acquisition and created a higher level of ECL provision which is visible when you look at the segmental results. Rs.48 Crores is the hit that CV business has taken while purely on write-off alone we have taken Rs.64 Crores overall, and obviously on the IndoStar book also there is some incremental provision as the book has grown. Effectively there is a release from that incremental provision that has happened. Our overall ECL provision was around Rs.202 Crores when we on-boarded the loans from IIFL.

Akash Dattani: Okay so if I understood correctly last time is there any sort of backstop that IIFL will have provided for this book?

Prashant Joshi: IIFL had provisions on their book and also gave us cash in a way resembling a first loss default. This quantum effectively became an ECL provision of Rs.202 Crores. As the IIFL book winds down over the next 28 months, at the end of period, if we effectively end up losing more than Rs.202 Crores that loss will be to our account.

Akash Dattani: Okay out of this Rs.202 Crores, what is the loss that you all have suffered until now on this book?

Prashant Joshi: The right way of looking would be to consider effects of (i) combination of portfolio decreasing (ii) loans that may have shifted between buckets and (iii) write-off that we have taken. At present, of the original ECL pool of Rs.202 Crores created, the current balance stands at around Rs.171 Crores.

Akash Dattani: Okay got it and in the other segments particularly SME and corporate, there was a reversal in ECL provision in the last quarter and so corporate still understandable because one account has slipped and in SME now there are provisions again versus the reversal last quarter so is there any change in the underlying ECL model?

Prashant Joshi: No the underlying ECL model has not undergone any change, if you see, gross NPL have moved up, (owing to five-six accounts seeing slippage of about Rs.13-odd Crores) which results in certain amount of ECL growth and a few initial buckets have increased and therefore there is incremental provision. Having said that, in this quarter, our first few auctions become eligible for SARFAESI. Going forward we should see lower numbers in this business.

Akash Dattani: And how are we looking at traction on the SME business in terms of disbursals and what is the strategy for say the year?

Prashant Joshi: SME Finance has lower margins relative to our other businesses. So, we had taken a conscious call of just doing enough to keep the book flat, which is what you see over the last nine months or so. We are right now in discussion with two banks for Co-Lending or partnership lending (ICICI-like arrangements) and we think that in the next 30-45 days some arrangements would fructify. Going forward, we believe SME Finance growth is more likely to be driven by off-Balance sheet sourcing.

Akash Dattani: And my last question is on tie-up with ICICI Bank so as business started under this arrangement?

R. Sridhar: Commenced towards end of July-19

Akash Dattani: Okay so what would be the outstanding book on?

R. Sridhar: Just started about 10 days back. We have done small volumes in July and from this month we should be ramping up volumes.

Akash Dattani: Okay and if I understood it correctly there will be no asset or liability that is recognized on IndoStar's books under this arrangement only an income to the extent of 5% - 6% on the assets co-originated will show up under revenue from operations?

R. Sridhar: Yes.

Akash Dattani: Okay that is it from my end. Thank you so much.

Moderator: Thank you. The next question is from the line of Rajneesh Mehan, an Individual Investor. Please go ahead.

Rajneesh Mehan: I have two, three questions so one is regarding the IIFL again acquisition in last quarter, I had asked about this and you said that deal is structured in such way that whatever NPA comes about will be taken care of. So, I do not still understand reasons for gross NPAs and NPA having shot up?

R. Sridhar: When we acquired the IIFL CV finance business, we inherited about Rs.220 Crores of loans that were non performing. As a part of the due diligence process, we had employed CRISIL and Ernst & Young to estimate credit loss which may potentially come about from the total loans originated. After completing their investigations, they arrived at an estimation of expected loss against which India Infoline has provided us cash, which should protect as long as actual losses are within this expected loss estimate. This protection that we have received from IIFL will remain with us till this portfolio runs off at which time we would know whether actual loss incurred would be greater than our estimates or otherwise. In a situation of actual loss exceeding expected loss, we would need to take further P&L hit. In the event, actual loss undershoots expected loss, we may have some benefits.

Rajneesh Mehan: So, out of the consideration of about Rs.2400 Crores for the deal, is IIFL supposed to discharge an amount of Rs 200 crores IndoStar?

R. Sridhar: The consideration for the deal payable by IndoStar is over a period of 12 months. As explained earlier, IIFL has provided us cash to the tune of the estimated credit loss which we think insulates the acquired portfolio completely. To make this simple for understanding, kindly note that the cash provided by IIFL as ECL provision covers around 9% of the total portfolio which can compared to a First Loss Default Guarantee (FLDG) of 9%. In our recent partnership, we have agreed to provide ICICI Bank FLDG of 8% which is lower than what we have structured on the IIFL deal. We believe based on our due diligence and our long experience of running the CV finance business, actual credit losses are much lower than the FLDG protections structured and we think there is more than adequate protection available to cover any imminent losses from the portfolio acquired.

Rajneesh Mehan: I was just referring to slide #21 in your presentation; Could you clarify the various numbers for GNPA and NNPA?

R. Sridhar: Gross and Net NPA for the entire CV finance book (including the acquired IIFL CV finance book) is 7% and 5% respectively. To give you a better flavor of the makeup, we have provided numbers on organic performance as well. Incidentally, organic CV finance Gross and Net NPAs are 1% and 0.7% respectively. I would also like to draw your attention to slide #13 in the presentation where we have provided movement analysis of NPLs in the acquired CV finance book. Please note that after rising in the initial months, there has been improvement in collections which is reflected in NPAs getting arrested and as at July end, absolute NPAs are well below March-19 when the portfolio was acquired by us.

Rajneesh Mehan: Okay Sir second question is slide #12 if you see your gross NPA across all the businesses have gone up, which you see in that slide so what do you foresee going forward as you scale the business? Do you think these numbers to continue growing?

R. Sridhar: If you look at corporate lending, we have maintained a track-record of zero credit loss for the past eight years. Occasionally we have had instances of NPLs, but we have always achieved full collections and we are confident of maintaining this performance in the future as well. During the current quarter we have seen one account slipping (value: Rs.154 Crores) which is well covered with good collateral and security structures. We are already initiating collection efforts and are confident of fully recovering our dues within the financial year.

Moving on to NPAs in CV finance, the organic book has delinquencies of around Rs.19 Crores representing less than 1% NPL which is a very good performance in our view. On SME Finance, the NPA level is around Rs.67 Crores and we hope to bring this down as we are expecting resolutions to work out over the next few quarters. We also hope to benefit from SARFAESI which will enable us to put collateral on block and achieve superior recoveries.

Finally, the NPAs in Housing Finance is just a mere Rs 2 crore and at 0.3% gross NPA, we reckon this to be an excellent performance.

In summary, barring the Rs.150 Crores slippage in corporate lending during the quarter, other retail business delinquencies are well under control. We are very confident that the slippage in corporate lending would get collected in the forthcoming periods.

On IIFL acquisition related delinquencies, we are very confident that actual losses will be meaningfully lower than the ECL provisions that we hold.

Rajneesh Mehan: What is your projection for AUM and growth?

R. Sridhar: We don't issue a formal guidance but our growth aspiration is around 50%. That said, in light of the current market conditions we would be happy with growth between 30-40%.

Rajneesh Mehan: Okay thank you.

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

Deepak Poddar: Sir given now that your CV financing business has been integrated so what sort of credit cost profile are you looking at going forward, I understand there was some one-off in Rs.61 Crores provision that you have reported this quarter right?

R. Sridhar: The write-off of Rs.50 Crores hasn't come up suddenly. We took the call only after completing a thorough evaluation of loans that had not seen collections for a protracted period of time. That said, the collection effort will continue and there will be some collections in these accounts in the future. I will like to put on record here that we were aware of the potential for such situations and hence we priced the same in the deal as well by building in a liberal FLDG.

Going forward we think our normal business blended yield would be around 16-16.5%. We think risk adjusted yield should range between 14.5-15%, implying a credit loss expectation of around 150 bps.

Deepak Poddar: That is fair enough so when you are talking about is 1%, 1.5% you have also kind of factored in the loss that you might see in your corporate book as well right?

Shailesh Shirali: I think Mr. Sridhar's answer was limited to CV Finance.

R. Sridhar: My response was for your query on CV Finance. On corporate lending, we have had a zero-credit loss track-record so far. So, I would believe that there will be no credit loss in future also. In SME, there could be some credit loss but that also will be less than 50 bps.

Prashant Joshi: SME till now in the last four years, our eventual credit cost has been about 50-60 basis points and that is where we think it will be and housing to be fair it has been two years and there is virtually nothing out there till now.

Deepak Poddar: Can you just repeat it 60-65 basis points you mentioned right?

Prashant Joshi: That is right 50 to 60 basis points of credit loss in case of SME and housing as I said in the last two years, there has been virtually nothing.

Deepak Poddar: So on overall basis (as your corporate book is also substantial position) you do not expect any substantial credit loss; So, will overall credit loss of 50-100 basis points be a fair assumption to make?

R. Sridhar: Correct absolutely.

Deepak Poddar: Okay and Sir what sort of ROE profile are we looking at like on a steady state basis once we have fully integrated, what sort of ROA kind of business because earlier we used to be in the range of 2.5% to 3.5% right?

R. Sridhar: Normalised ROA is around 2.5% to 3%. Adjusting for write-off it should be around 3% so with the leverage of 5 to 6 times we should get to 15% to 18% band. We think we should reach this band in the next two years. We are already in the double-digit and will move slowly to our aspirational range.

Deepak Poddar: That is ROE and ROA 2.5% to 3%?

R. Sridhar: Correct.

Deepak Poddar: Fair enough and that will take about two to three years is that you mentioned?

R. Sridhar: See gradually every quarter it undergoes a change, I cannot put a timeline to it under the current market condition, but that is our aspiration where we want to reach and earlier the better.

Deepak Poddar: Understood. Thank you so much Sir and all the very best Sir.

Moderator: Thank you. The next question is from the line of Subranshu Mishra from BOB Capital Markets. Please go ahead.

Subranshu Mishra: My first question is with regards to your bank funding I see that it has gone up on a sequential basis so what is the bank funding now coming at right now, what price and what was the risk premium that was being charged a year ago and what is it right now even a ballpark number would do Sir that is my first question?

R. Sridhar: In the last three quarters, we have been able to mobilize totally Rs.3600 Crores out of which 50% has come from bank about Rs.1800 Crores and another Rs.1200 Crores has come from capital market and Rs.600 Crores by way of portfolio sales. The marginal cost of funding would be around 10%.

Subranshu Mishra: My specific question is about banks, what was the risk premium in June 2018 above the MCLR and what is it as on date?

Pankaj Thapar: It has seen an increase of depending on the bank between 50 to 80 basis points.

Subranshu Mishra: Right and my second question is with regards to securitization what kind of credit enhancements is the counterparty asking for or what are the excess cash collaterals that you are giving, what has been incremental need in it from a year ago?

R. Sridhar: A year back we were not doing securitization, we had done only assignment, assignment is going in the normal ratio of 90:10, there is no change as far as that is concerned. In case of securitization specifically pass through certificate whatever we have done we have done in the last two quarters and we have done all AAA rated structure and that is only for CV business where the cash collateral has been in the range of 12% to 15% and it has remained the same since February till date.

Subranshu Mishra: Right and my last question pertains to your disbursements especially in CV and the SME business which have come off sequentially, how do we look at the CV and SME disbursements in the next three quarters full-year guidance or how do you look at the disbursement as such one if you can structure the answer for the entire industry in terms of the CV disbursement that you think can happen, second would be company-specific answer if you can please help me with that?

R. Sridhar: For the entire industry you know that CV industry is going through a down cycle, so the vehicle sales have come down substantially; this happens every four to five years but unfortunately this coincides with the time when liquidity challenges too persist. In this backdrop, truck owners are not enthused to go and buy new vehicle. Having said that, the large three companies which have been there like Sundaram, Shriram and Chola continue to generate reasonable business and have seen many such cycles so the industry will manage the current phase as well.

In relation to IndoStar, we have augmented capacity after the acquisition and have the capability to disburse Rs.300 Crores, Rs.400 Crores per month. However, constrained liquidity, got us to be conservative and chose not to convert all our cash into receivables. We have been a little bit slow and cautious and that is why you will find that our disbursements have been marginally lower than Q4. After this tie-up with ICICI Bank, we don't foresee any liquidity issues, and are confident of moving closer to our monthly disbursement capacity of around Rs 400 crores in due course.

Subranshu Mishra: Right Sir and Sir just one last question if I can squeeze in individually for your IIFL portfolio that you have acquired and vintage IndoStar portfolio, what is the zero DPD as of July 31, 2019?

R. Sridhar: For IndoStar I will be able to say, IIFL I have to check, IndoStar should be near to 90%.

Subranshu Mishra: That is the zero DPD?

R. Sridhar: This one we will check and get back to you.

Subranshu Mishra: And IIFL Sir, ballpark number would also do if you have it Sir?

R. Sridhar: I do not want to quote any number at this juncture as full integration has not happened.

Subranshu Mishra: Sure Sir. Thank you so much Sir. Best of luck.

Moderator: Thank you. The next question is from the line of Jayprakash Toshniwal from India First Life Insurance. Please go ahead.

Jayprakash T: So, on this corporate NPA Rs.155 Crores what is provision we are carrying and on the corporate book as a whole, are we maintaining any specific provisions?

R. Sridhar: So, on this NPA, we are carrying Rs.16 Crores provision. We are carrying some excess provision as miscellaneous provision, against all of our assets which could be used for corporate or for any other business. Overall our provision is in excess of the RBI requirement.

Jayprakash T: Okay and on the IIFL book on slide #13 where you are saying ECL provision has reduced from March which was Rs.26 Crores roughly, is it so Rs.50 Crores write-off is over and above this number or how should I see this?

Prashant Joshi: It is subsumed in that. This is the net result of the write-off of recovery of reduction in portfolio of portfolio changing bucket everything so it is net result of all these things.

Jayprakash Toshniwal: Okay thank you.

Moderator: Thank you. The next question is from the line of Tushar Sarda from Athena Investments. Please go ahead.

Tushar Sarda: My question is again on the same IIFL thing so is this Rs.50 Crores write-off is still taking is in addition to Rs.200 Crores or still be part of Rs.200 Crores?

Prashant Joshi: Rs.200 Crores represents a budgeted provision that we have created for ourselves for eventual loss in the portfolio, so the Rs.50 Crores is part of that.

Tushar Sarda: So ultimately if the loss is less than Rs.200 Crores, this Rs.50 Crores will get reversed right?

Prashant Joshi: If the loss on the whole portfolio if it turns out to be less than Rs.200 Crores to the extent it is less that will be net gain to us.

Tushar Sarda: So, this Rs.50 Crores will get reversed from the P&L?

Prashant Joshi: Recovery against Rs.50 Crores will get reversed from the P&L. As I explained, there is difference between NPA and NPA means the asset is at stress. The ECL means I have made provision against possible loss, but the final loss is something that can only be known when all is said and done.

Tushar Sarda: I agree with you I understand that. My question is if the loss is less than Rs.200 Crores, we would have not charged in P&L?

Prashant Joshi: We will have reversal in P&L, we will have a credit entry if my final loss against the IIFL portfolio is less than this number, I will have a P&L credit.

Tushar Sarda: That is what I wanted to understand. Thank you.

Moderator: Thank you. The next question is from the line of Rajneesh Mehan, an Individual Investor. Please go ahead.

Rajneesh Mehan: Sir this is regarding this real estate asset when you are saying in the corporate one, you have provisions for Rs.150 Crores so how much is this like percentage wise provision, I mean what is the total loan to that as the real estate?

R. Sridhar: Loan is Rs.155 Crores, the provision is 10% of that.

Rajneesh Mehan: Okay. Thank you.

Moderator: Thank you. The next question is from the line of Tushar Sarda from Athena Investments. Please go ahead.

Tushar Sarda: On your this co-lending with ICICI Bank you said that you will provide 8% as capital. So, does this increase your ability to leverage to much higher levels?

R. Sridhar: The partnership deal with ICICI Bank will require us to maintain much lower levels of capital and therefore increases the scope for us to leverage higher.

Tushar Sarda: Okay thank you.

Moderator: Thank you. As there are no further questions, I will now hand the conference over to Mr. Piran Engineer. Over to you Sir!

Piran Engineer: We thank the management for giving us this opportunity to host the concall and all the best everyone.

Moderator: Thank you. Ladies and gentlemen, on behalf of Motilal Oswal Financial Services, that concludes this conference call for today. Thank you all for joining us. You may now disconnect your lines.