“IndoStar Capital Finance Limited
Q2 FY2020 Earnings Conference Call”
November 08, 2019

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Moderator: Ladies and gentlemen good day and welcome to the IndoStar Capital Finance Q2 FY2020 Earnings Conference Call, hosted by Motilal Oswal Financial Services. As a reminder, all participants' 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 Steven. Welcome to the call. With us we have the entire management team of IndoStar led by Mr. R. Sridhar the CEO. Over to you Sir!

R. Sridhar: Good afternoon to all of you. First off, I would like to give the highlights of Q2 FY2020. Net interest income has gone up around 19% and pre-provision operating profit is up 21%. AUM has remained flat, roughly around INR 11,000 Crores compared to Q1 and our retail to corporate mix has changed considerably.

The cost to income ratio has come down from 38% to around 36% and our NIMs are very comfortable during the quarter at about 8% attributable to our retail businesses. You would also note that the quality of our assets has improved substantially particularly in the CV financing business.

The P&L has an element of provisions of around INR 50 Crores on two accounts (in the non-real estate segment) where we felt that there could some stress going forward in the next few quarters. We have taken a precautionary provision on a very conservative basis and as a consequence of this provision our profit after tax is at INR 49 crores lower by 23% compared to the year-on-year INR 64 Crores; On a half-year basis PAT was broadly flat at INR 97 Crores.

Disbursements have been down this quarter due to (i) the liquidity scenario in the industry and (ii) gradual build up in momentum on the partnership with ICICI Bank (which commenced towards the end of July'19). In the first quarter after operationalizing this partnership, IndoStar has sourced business of INR 165 Crores and we expect volumes to go up significantly from the current period onwards.

With this overview, I open the forum for questions and we would be very happy to answer.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Nausheel Shah from Capgrow Capital. Please go ahead.

Nausheel Shah: On slide 12 of the presentation, the corporate lending has not changed, but as far as I know that one business account which you had lent too has been downgraded to default by rating agencies. Has that been recognized as NPA?

Shailesh Shirali: Right now it is less than 90 days past due (dpd) in our books; As Mr. Sridhar said, we have already made provision for two accounts, and this is one of them which may possibly slip to stage 3 if there is no progress or if there is no restructuring in the current quarter.

Nausheel Shah: Okay and what sort of recovery do you see in that stressed account?

Shailesh Shirali: We had about INR 80-90 Crores exposure out of which almost INR 30 Crores has already been recovered. So, our exposure in four operating subsidiaries is small (amounts ranging from INR15-20 Crores each). For one of the subsidiaries, we have found a buyer and we have recovered that amount leaving the residual outstanding to INR 60 Crores against which we have made a provision of 25-30%.

Nausheel Shah: I will just come back in the queue for further questions. Thank you.

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

Akash Dattani: Good afternoon Sir and thank you for taking my questions. My question is on the yields this quarter. I assume that part of the reason for this bump up would be higher securitization and assignment done during the quarter as well as some income possibly recognized on co-origination is that the correct interpretation?

R. Sridhar: You are absolutely right. A lot of it actually has got to do with assignment led income and, on the co-origination, there has been income but it is not as significant as the assignment income. Also, overall in the retail businesses rates have inched up for new originations;

Akash Dattani: Would you be able to specify the amount of income recognized on securitization and assignment during the quarter included in right from operation?

Prashant Joshi: I think it is around INR 25 Crores for this quarter.

Akash Dattani: Sir my next question is on asset quality, would it be fair to assume at present the gross stage 2 does not include anything apart from the two accounts for which the INR 50 Crores provisions has been made this quarter?

Prashant Joshi: Off the two accounts wherein we have taken a provision, one of the accounts is considered as a Stage 2 account. There are no other accounts within Corporate Lending which are categorized under Stage 2. Kindly note that the classification under Stage 2 for this account was driven by an early alert event and not necessitated by poor performance.

Akash Dattani: So, need to classify as Stage 2 was driven by increase in credit risk?

Prashant Joshi: Yes

Akash Dattani: My last question relates to AUMs. Does it include any of the loans under co-origination?

Amol Joshi: AUMs will include the loans sourced under co-origination with ICICI Bank.

Moderator Thank you. The next question is from the line of Gautam Jain from GCJ Financial. Please go ahead.

Gautam Jain: Good afternoon Sir. We have recognized an NPA INR 150 Crores in Q1 right Sir?

R. Sridhar: Correct.

Gautam Jain: This quarter we have made some contingent provision on corporate portfolio of around INR 56 Crores?

R. Sridhar: INR 50 Crores represents precautionary provisions taken for two accounts within Corporate Lending.

Gautam Jain: Are these accounts different from the NPAs recognized in Q1?

R. Sridhar: Absolutely. These two accounts are not NPAs as of now. We see stress in these two accounts hence we have made precautionary provision of INR 50 Crores.

Gautam Jain: I missed few questions, so can I ask again what is the total exposure to do these two accounts?

R. Sridhar: INR 200 Crores.

Gautam Jain: Against which we have made provision of INR 50 Crores?

R. Sridhar: Right correct.

Gautam Jain: In your interview, TV interview says further provision can come in Q3 and Q4, is that correct?

R. Sridhar: I said that in coming quarter we will evaluate these two accounts and then decide whether there is a deterioration or an improvement; This would drive the need to take provisions. At present, the recovery process is underway so we will not know as of now. Further, these are not NPAs currently and should they become NPAs in future, we will evaluate and decide on effecting further provisions.

Gautam Jain: Are these exposures secured?

R. Sridhar: Yes they are secured exposures.

Gautam Jain: Okay apart from these two accounts are we seeing any other stress or stage 2 accounts within the corporate portfolio?

R. Sridhar: We are very watchful about portfolio quality and currently we are comfortable with the level of provisioning that we have made. Further, there is just one account which is under Stage 2 (something that was already highlighted earlier as a response)

Gautam Jain: No that is what we have said in Q1 but we did not expect any stage 3 assets in Q2, but now we are saying two account are seeing stress; Can you provide some qualitative comments as to how is the overall corporate book behaving and what is our expectation on stress by year end?

Shailesh Shirali: If you go a little bit into history, in last July the book was INR 5,400 Crores which was about INR 3,000 crores of real estate and balance loans were from the non-real estate segment. This loan book as on date has come down to INR 3500 Crores that is ~ INR 2000 Crores reduction. We expect the book to further witness reduction to INR 2,800 Crores by March-20 as per normal repayments and trends that we are seeing. As of now we do not expect any more negative surprises here and even during the previous quarter, we had pointed out that one of the accounts was showing some weakness wherein we have taken a provision in the current quarter.

Gautam Jain: Okay one of these two accounts is media account.

Shailesh Shirali: Yes.

Gautam Jain: Okay thank you Sir. Thank you so much.

Moderator The next question is from the line of Pritesh Vora from Mission Holdings. Please go ahead.

Pritesh Vora: Sir again this INR 200 Crores exposure which you are saying. What kind of security coverage we have, what kind of collateral do we have?

Shailesh Shirali: In one of the cases it is mix of fixed and current assets, more than 1X cover; For the other account, there are shares. (Loan against shares)

Pritesh Vora: More than 1X cover is it?

Shailesh Shirali: In one of the cases (exposure ~ INR 60 Crores) collateral is fixed and current assets; For the account from the media space, the lending is against collateral of shares (LAS) .

Pritesh Vora: Is coverage sufficient to effect full recovery or do we expect significant haircuts?

Shailesh Shirali: We have already provided over 25% (account in the Gym business) which is still not an NPA on our books. It is going through a restructuring process, once things are clearer, we will have to take a call. As total exposure is around INR 60 crores and we have taken a provision of ~INR 20 crore, we have to take a call on whether to provide further or not once the restructuring becomes clear.

Pritesh Vora: Can you highlight the scalability of the partnership agreement in CV financing with ICICI Bank over the next few years?

R. Sridhar: Our capability as of now with current infrastructure (built + acquired capacity from IIFL) enables us to potentially disburse or source INR 4,000-5,000 Crores per annum. As you aware, that CV industry is currently going through a cyclical slowdown. We are cautious in not growing the book too much, so it is a combination of a liquidity constraint plus the industry slowdown which affects our delivery on business volumes. However, I am confident that with the festival season starting, good monsoon etc. should provide a good pickup in activity which should help drive up volumes in our business. Over the next 2 to 3 years factoring in a recovery in the CV industry, we should be able to achieve volumes of INR4,000-5000 crores per annum without any further increase in people or infrastructure.

Pritesh Vora: Will you adopt a business model of Cholamandalam or Shriram Transport Finance?

R. Sridhar: Our focus customer segment has greater similarity with Cholamandalam than Shriram. Shriram Transport is operating in the bottom most customer segment, which are first time users; Our customer focus is on the mid segment which is more or less Chola's customer segment; The main differentiator between us and Chola relates to choice of business mix wherein we would choose to be more active in the used vehicles space versus Chola wherein there is a higher proportion of newer vehicles financed.

Pritesh Vora: Could you comment on asset mix between retail and corporate once CV financing scales up meaningfully?

R. Sridhar: Our intent is to keep the mix at around 25:75 (Corporate to Retail); We were at 75 and 25 (two years back); We think we can achieve the desired mix by March 2020 and we will try to maintain that in the future.

Pritesh Vora: Alright Sir, wish you all the best. Thank you very much.

Moderator Thank you. The next question is from the line of Dhruv Kapoor from Waterbridge Capital. Please go ahead.

Dhruv Kapoor: Sir thank you for the opportunity. Sir I had a couple of questions. One would be what would be our incremental sources of borrowing and the incremental cost of fund in relation to that?

R. Sridhar: The incremental funding is predominantly from banks and we have also started doing off balance sheet which involves selling of portfolios and the third one which we are doing is direct lending by ICICI Bank under our partnership tie-up. We have still one more source viz. Overseas Borrowing (ECB) which we have not exercised until date and we may use this window in future.

Dhruv Kapoor: What are the incremental costs, at what rates are you borrowing from the banks?

R. Sridhar: It is around 10% to 10.5% on balance sheet, 9.5% to 10% on off balance sheet windows.

Dhruv Kapoor: Sir despite the acquisition of the IIFL business the vehicle finance disbursements were pretty low in the quarter, so it is general industry phenomenon or anything else?

R. Sridhar: Two things, one is liquidity and the other one is industry slowdown.

Dhruv Kapoor: What is your guidance on credit costs for 2020-21?

R. Sridhar: See as of now our retail business has stabilized, so there could be only improvement not much of deterioration there. Within the corporate book, we have already highlighted the accounts wherein we taken some precautionary provision; For one of the accounts already declared as NPL in Q1, we will be able to recover the money by end March-20. For other accounts, we have to wait and see how the recovery process plays out.

Dhruv Kapoor: Sir one last question on the recent announcement by the Finance Minister on the stress is related to the real estate project what is your thoughts on that as to how much of the total units or the stress can be resolved by this fund and for the industry overall as well?

Shailesh Shirali: Overall, it is positive for the industry but we have to wait and see the devil is in the details and we have to see how exactly it will be implemented; So, it evolves over a period of time.

Dhruv Kapoor: Thank you very much.

Moderator Thank you. The next question is from the line of Nausheel Shah from Capgrow Capital. Please go ahead.

Nausheel Shah: Can you comment on the IIFL portfolio which you acquired a few quarters back? Do you think the coverage of INR 145 Crores is adequate going forward?

R. Sridhar: Out of INR 140 Crores NPL in the CV financing business about INR 120 Crores relates to the IIFL portfolio. We have made tremendous progress in curtailing the NPL in the last 6 months as is reflected in the NPL numbers from March through to September 19. We believe the business acquisition is working out well for us; The integration is in the final stages and we should complete branch consolidation, people have been allocated to different places and they have all started business origination under the co-origination tie-up with ICICI Bank. So overall the acquisition decision is working out well.

Nausheel Shah: The second question on the real estate portion, so that has now increased to 73% as a percentage of your corporate lending so what sort of a mix do you see in that and what kind of repayments of are you seeing in the real estate side of the portfolio?

Shailesh Shirali: I do not think it will be a correct way to look at as a percentage of the corporate lending book because now we have about 5-6 products, so from a peak of about 70%-80% of the balance sheet, it is now about 23% of the balance sheet is the way we would look at it. It is at INR 2,500 Crores and the peak was about INR3,000-3500 Crores some time back; Within the INR 2,500 Crores about INR 400-500 Crores are actually projects where we have got OC and thus the receivables are coming through the escrow and we get paid out. At least INR 300 Crores of repayment should come through between now and March purely from these completed projects. The others are ongoing projects where we are seeing regular repayments from the escrow; We have mandatory prepayment mechanism in the escrow, we are seeing regular prepayments happening there, so I would expect this INR 2,500 Crores to go do down to below to INR 2000 Crores by March on the real estate segment itself.

Nausheel Shah: Thank you.

R. Sridhar: Thank you.

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

Akash Dattani: Thanks once again. Just a quick question it is in relation to the previous participants question, so if I look at the vehicle finance, NPAs has seen a sharp improvement in quarter-on-quarter and while Mr. Sridhar mentioned that there have been significant recovery efforts, are there any write off too?

R. Sridhar: No. We had a taken a write off in Q1.

Amol Joshi: We took a write off of INR 50 Crores in the last quarter specifically for CV and there is no such large write-off during the quarter. There could be some small amounts which are in the course of regular business but not exceeding INR 5-10 crores which represents shortfalls after making recoveries.

Akash Dattani: Okay so this is about INR 5-10 Crores for the quarter.

R. Sridhar: Yes.

Moderator: Thank you. As there are no further questions, I now hand the conference over to management for closing comments.

Piran Engineer: Thank you for your enthusiastic participation. I hope that we would have clarified all your queries. In case if you have any further queries, please do contact us, we would be very happy to answer. Thank you very much.

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