“IndoStar Capital Finance Limited
Q4 FY2020 Earnings Conference Call”
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Moderator: Ladies and gentlemen, good day and welcome to IndoStar Capital Finance 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: Thank you. Welcome all to this conference call of IndoStar Capital Finance. We have with us Mr. R. Sridhar, Executive Vice Chairman & CEO, Mr. Shailesh Shirali, Whole Time Director, Mr. Prashant Joshi, Chief Operating Officer, Mr. Amol Joshi, Chief Financial Officer and Mr. Pankaj Thapar, Director of Strategy. I would now like to handover the call to the management for the opening remarks following which we can take Q&A. Thank you and over to you Sir!

R. Sridhar: Good morning to all of you. First, let me wish everyone of you and your family health and safety in this COVID scenario and I would also like to thank each one of you for taking time out to participate in this call. Let me first provide an overview of how we have approached the scenario which started from the IL&FS failure. The IL&FS episode brought about liquidity stress which has persisted for over a year and got accentuated post COVID. IndoStar, which was predominantly in the corporate lending business had an impeccable run with high profitability and good asset quality until March 2019. Post IL&FS and the resultant tight liquidity environment, prompted us to run down this portfolio. Over the last 24 months, we have been able to bring it down by 50%. The peak portfolio during middle of 2018 was around Rs 6,000 core and now we have brought it down to Rs 3,000 crore which clearly means we have been able to collect Rs 3,000 crore during this period from our borrowers, which indicates the fundamental quality of the book. Having said that, we have faced few stress points in some of these accounts. In the corporate lending business, we had two accounts, information of which is present in public domain, one in media and another fitness company where we have taken assertive action. So, we thought that running down the book over the next 12 to 18 months should help us protect the balance sheet from the risks associated.

The second most important thing which happened for IndoStar in these challenging times is the interest shown by a very strong partner - Brookfield. They have recently invested Rs 1,225 crore in equity of the company, strengthening our capital, net worth and pushing up our capital adequacy to ~ 41%. Our leverage after this investment has reduced to ~ 1.5 times thereby making IndoStar one of the strongest NBFC firms in the industry. We consider this partnership very significant for the company. The pedigree of the investor partnering with the company in challenging times clearly indicates the confidence of the investor in our franchise.

Third most important decision which we took after deciding to rundown the corporate lending portfolio and bringing in a partner with huge capital in this challenging times was to aggressively build provisions and accelerate write off in some of these corporate lending borrowers as well as in some cases in the retail business. The full amount of the RBI prescribed 10% provision on the moratorium book has been taken in Q4 while the RBI has allowed companies to take it over Q4 FY 20 & Q1 FY21. The conservative approach adopted has strengthened IndoStar's position and places it ideally to take advantage of future growth opportunities. We are now looking to the future to build our retail business over the next three to five years. We have broken our strategy into two parts; The short-term strategy, where the impact of COVID is going to be very significant until September, is centered around focusing on three important things, liquidity, controlled operating expenses and managing asset quality. With the recent capital infusion IndoStar's liquidity strength has improved considerably and can withstand extreme events and we can honour all our liabilities without raising fresh money from banks or institutions and with stressed inflow scenario until March 2021.

The second important thing relates to control on operating expenses. So the moment COVID started we have frozen new recruitments and eliminated superfluous positions which in turn will provide cost savings. Another driver of cost control is driven by branch rationalisation. The infrastructure inherited from IIFL (161 branches) has been rationalized. Our current distribution is 230 branches across 18 states. We are now merging a few more branches as we progress through the year. Further, we are also getting into a lot of digital initiatives to interact with customers which should over time bring significant reduction in operating expenses. We think a reduction of around 15% in operating expense levels of FY2020 is possible.

The third focus area is asset quality. Asset quality of the company has always remained good, but during these times, where the moratorium has been given by Reserve Bank, there is a chance that there might be some surprise once the moratorium period is over.

As far as moratorium roll-out is concerned, we decided to give the first moratorium to all the customers who are standard. NPL customers were not given any moratorium. Within, standard customers, some of them did not opt for it and we managed to collect their dues. Further, customers that opted for moratorium have also slowly started paying up as is reflected in collections between March-May 2020. As far as the second moratorium period (June to August) is concerned, we decided to calibrate our approach while giving moratorium. Customers needing moratorium are required to apply for the same. We are confident that between June - August, the number of people who are not going to seek moratorium is going to increase substantially. In June we are expecting to receive repayments from more than 50% of our customers. Further in July and August, we expect the number to increase substantially.

In the long term, we are going to look at growth opportunities in the CV and affordable home finance area. In the CV finance business, used vehicle financing will be our focus and as all of you are aware that used vehicle financing is a profitable business where only very few companies are present. So IndoStar with its background and track record and what we have been able to achieve in the last two or three years is well placed to take advantage of the replacement demand in the 5 to 12 year old segment plus the demand which will unfold on account of scrappage policy as and when it is introduced. Hence, we are preparing ourselves to take advantage of the potential which should come about in the next few years. No doubt we will also be present in the new vehicles, but the new vehicles would likely be an off balance sheet activity. We will source business here but redirect it to the balance sheet of banks with whom we would partner.

Second important area which we would focus for growth in the retail business is Affordable Home Finance. As you all know, affordable home finance is a very high potential business but the experience of some of the companies have been very, very different in this business. IndoStar stepped into this business about two-and-a-half years back and we have built about Rs 800 crore + portfolio with excellent quality and profitability. Our portfolio yields are around 14% and customers in the Current bucket make up 99% of the loan book. This gives us confidence about the capability of our team and now with the Capital we can look at making this business grow on its own strength and scale up further in the next three to five years. So these two businesses Vehicle Finance and Affordable Home Finance are going to be our focus and if we look at the growth which we have achieved in the retail business in the last two-and-a-half to three years from the time we started in December 2017 we have grown this book about four times. This is an indication of the capability of team which can do wonders over the next three to five years.

While in the immediate future we are going to be cautious considering the current environment and with the kind of provisions and aggressive write-offs we have taken the portfolio is ringfenced. With the capital we have raised, it has made our balance sheet very strong and resilient and as and when normalcy is restored, IndoStar will be amongst the NBFCs well placed to take advantage. The very important strength of IndoStar apart from the balance sheet strength and liquidity is it's size. At present, our AUM is ~ Rs 10,000 crore out of which if you take the corporate lending business of Rs 3,000 crore, our retail business stands at about Rs 7,000 crore. So this Rs 7,000 crore is where some of the large NBFCs were about 10 years back. I consider IndoStar to be at a stage of inflection, where with the size being small, growth prospects are very strong for IndoStar as the size makes it possible for us to look at huge growth. Whereas big companies will find it difficult to grow very fast because of the liquidity and capital constraints. We would become a more or less 100% retail company in the days to come and we are confident that we will build a very high quality, highly profitable platform with good governance which should help deliver excellent returns to every stakeholder. I am very confident that with the kind of team we have we will be able to do it. With these remarks, I leave the floor open for 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 Aakash Dattani from HDFC Securities. Please go ahead.

Aakash Dattani: Thank you for taking my question. I have a couple of them. First bookkeeping question so if I look at your operating expenses there appears to be a spike this quarter that comes from the unallocated portion so is it possible if you could elaborate on that please?

Amol Joshi: Our corporate centre absorbs most of the common cost for the entity. We have undertaken a lot of projects internally and these costs are housed in the corporate centre.

Aakash Dattani: Also in terms of the accelerated write-offs and regular write-offs that are disclosed in your investor presentation; would most of them pertain to this quarter?

Amol Joshi: Yes. If you look at the full year, P&L hit taken is Rs 864 crore of which Rs 244 crore was a number for nine months. The incremental hit for the quarter is Rs 620 crore.

Aakash Dattani: If I look at your segment wise credit cost in the vehicle finance and affordable housing segment they seem to be a little on higher side which was sort of alluded to in Mr. Sridhar's opening remarks could you possibly elaborate on this please?

Amol Joshi: For the housing business, it is clearly the COVID-19 overlay which we have done, so there are two aspects which go in all our provisioning decision one is clearly the regulatory minimum which we use as a floor and as we are all aware RBI has asked us to do a top up provision of 10% so that clearly is built into it and the second aspect is the Covid-19 overlay. On the CV business we have taken accelerated write-offs and hence you find the Q4 number to be a bit elevated.

Aakash Dattani: This would pertain to the IIFL portfolio?

Amol Joshi: We have disclosed that in slide 8, the Rs 60 crore accelerated write-off in the CV business is Rs 30 crore for our organic book and Rs 30 crore for our IIFL book.

Aakash Dattani: I have two strategic questions pertaining to the opening remarks as well as your investor presentation. There is a mention that you could look at inorganic growth opportunities so what kind of asset classes would you sort of consider entering into?

R. Sridhar: See we have just mentioned an intent as we think that there will be lot of consolidation. Opportunities will emerge when things open up post lockdown, where NBFCs of small size will struggle owing to the liquidity constraints. While, we are not explicitly hinting at anything, we are only stating that our balance sheet strength gives us the potential to look at acquisitions favourably.

Aakash Dattani: Okay and on the corporate lending piece you did mention that you always want to sort of run this portfolio down but that being said for the longest time it has been a very profitable business and if a good opportunity were to come your way, and assuming it meets all your criteria would you sort of consider lending or it is something that is completely off the table for now?

R. Sridhar: While our initial strategy was to keep at it around Rs 5,000 crore and build retail on top of it, the kind of liquidity constraints we faced and the corporate and real estate sector difficulties and challenges in the last one year has forced a rethink. We have now decided that we should not lend further now and then run this book off so that is a very conscious decision we have taken. It is a tough call but, in this scenario, I think it is a good decision, so we are also indicating to the market clearly our intent is to build the retail financing company.

Aakash Dattani: Okay. I will squeeze in one last question Sir, the credit cost that you mentioned on slide 8 in terms of the write-offs and accelerated write-off in the corporate lending book, these pertain to only three accounts, two being in the non real estate bit and one real estate account that you have alluded to in your opening remarks as well as in previous calls right there is nothing else out there?

R. Sridhar: All the other things are performing well and majority of these provisions and write-offs are relating to only these 3 accounts apart from that whatever is there comes in the normal ECL.

Aakash Dattani: Okay, that is it from my end and thank you very much and best of luck.

Moderator: Thank you. We will take our next question from the line of Piran Engineer from Motilal Oswal Financial Services. Please go ahead.

Piran Engineer: Sir I have a couple of questions. On the CV side what sort of collection efficiency are we seeing there, what percentage is taken moratorium and any color on trends you see going forward, by going forward I mean over the next six to nine months that could be helpful?

R. Sridhar: CV business as you know Piran is earn-and-pay business and it has been facing headwinds for the last few quarters because the industry went through sluggish growth. Our portfolio was performing well and in March 2019 we the bought IIFL CV business, which we finished integrating in March this year. Now in the month of March, April, and May we went into a deep lockdown, first of its kind in India so we thought that we should give moratorium to every customer because they are not plying vehicle if you do not ply vehicle you cannot pay so we have given and it is about more than 85% of the people have opted for moratorium and some of them said we do not want, they have paid. So we have seen from March, April, and May gradually when the zones opened up many of our customers were plying vehicles but because of inherent problems on the road as well as driver shortage, they have not been able to fully operate the vehicles but number of people who started paying have gradually increased. For Moratorium 2.0 as I mentioned earlier we are going to give moratorium to only people who are genuinely in difficulty. In June from the trend which we are seeing more than 50% of our people have already started plying and money will be coming so gradually that will increase. The GDP plus the other issues which are there is going to impact the sale of new vehicles but as and when the customers have started plying the vehicles I do not think paying our installments will be a problem, but still considering the immediate outlook on the COVID impact, we have cushioned our provisions by taking aggressive and accelerated provisions and write-offs in CV business on some of the higher DPD cases. So going forward slowly and gradually this repayment will increase by September you will find that 100% of the people will come out of the moratorium and pay.

Piran Engineer: Right now is it fair to say the collection efficiency might be around 30 to 35% initial two weeks of June?

R. Sridhar: It is definitely more than that.

Piran Engineer: More than that, okay. Sir would you say that a single truck operator is better placed in this environment versus a large fleet operator or vice versa?

R. Sridhar: The large fleet operator is dependent on the industrial goods movement which is being carried on the National Highways. So unless the broader economy starts producing, there will be a problem with respect to loads and freight profitability. Decision to replace trucks will likely get postponed. Fleet owners will find it difficult because they are all not going to get the money from their logistics immediately. The credit period is increasing, but when it comes to the segment where IndoStar is operating viz. single lorry operators they are cash-and-carry business so they get the money immediately there will be no problem so that is why we have always felt that small and medium truck owners and used vehicles within the CV and road transport industry is better than new vehicles and fleet owners. That has been our strong belief and our stand has definitely been vindicated.

Piran Engineer: Actually another contrary school of thought that says if a fleet owner operate has demand for 100 trucks he will own only 60 and maybe 40 is outsourced and now the demand goes down the people he outsourced that will stop happening and maybe that is our customers segment so it will be more vulnerable, do you agree with that?

R. Sridhar: No not at all because the fleet owner is not having contract, people who have contracts are different. The fleet owner himself is outsourced by the large logistics company. For example if you take Hindustan Lever if it wants 1000 vehicles in Mumbai it will go to one aggregator and that aggregator outsources the requirement. Some fleet owners may have contracts, not all fleet owners so I do not think that point is valid. They will definitely face cash flow problems and the replacement of the vehicle will be longer because your BS-VI cost has gone up and overall business volumes are down, all these problems are definitely making them replace longer so that is why new vehicles sales, we expect, would be sluggish in the next three to six months, but used vehicles on the contrary is not creating new capacity, it will move from one person to another so I am very confident that once the COVID impact subsides the used vehicle demand will be higher than the new vehicle at least in this financial year.

Piran Engineer: Sir one last question on the CV front. I am looking at slide 21 actually Tamil Nadu is only 8% of our book, it is actually surprising compared to your peers and also the fact that your head office is in Chennai?

R. Sridhar: This is because earlier when we were only IndoStar this was very high because we started the business in Tamil Nadu and our head quarter was in Chennai, but subsequently you must remember Piran we bought portfolio from IIFL. IIFL portfolio had West and North that is why Tamil Nadu would be showing a little lesser, but it will catch up. South will always be 50% of Company's portfolio.

Piran Engineer: Fair enough. Sir on the corporate business what is the status of the three stressed accounts. How much of the portfolio have we written off how much is left on the book and from what is left on the book how much have we provided? If you can just give us some granular details that will be helpful?

R. Sridhar: See in one Entertainment Company we have zero exposure and in another fitness company about Rs 12 crore is pending for which we have got security, otherwise everything is written off .

Piran Engineer: And the real estate?

R. Sridhar: In the real estate, Amol can you tell?

Amol Joshi: There is only one asset which is a real estate developer in the North on which there is a provision of 20% as of 31st March and we are quite confident that the security covers the balance portion of the exposure

Piran Engineer: What is the outstanding in that?

Amol Joshi: Rs 154 crore.

Piran Engineer: And in the other exposure, we do not have any provision against the Rs 12 crore?

Amol Joshi: The Rs 12 crore is fully secured and a Stage 1 asset.

Piran Engineer: Barring these three there are no other stressed account?

Amol Joshi: We do not see any stress in the other parts of the portfolio.

Piran Engineer: Fair enough. Thank you so much. I will get back in queue for followup.

Amol Joshi: Sure. Thank you Piran.

Moderator Thank you. The next question is from the line of Nischint C from Kotak Securities. Please go ahead.

Nischint C: Just some comments you could make on the funding side I think you have raised fair bit of funding since April and in the fourth quarter also we raised around Rs 800 odd crore if you could just give some color in terms of what are you really raising at what rates and is it from PSU banks or private banks, is there any securitization, could you give some color on that and then maybe we will have specific questions?

R. Sridhar: Prashant would you like to respond.

Prashant Joshi: Majority of the funding that we have raised, particularly in Q4 on the securitization side has been a combination of public sector bank under the PCG scheme and the private sector banks, but majority has come from public sector banks under the PCG scheme. Thereafter the moneys that we have raised have come from three sources, we have raised money in the housing finance company from NHB, we also raised money from SIDBI, and we have also raised money from an insurance company and public sector banks after the lockdown. As far as the rates are concerned, it is a normal term loan, the rates have been in the range of about 9 to 9.5% incrementally. The institutional money from SIDBI, NHB are far cheaper than that and those are under specific schemes which were launched by the government, they are about close to 300 basis points lower than the number I mentioned before.

Nischint C: And how does the pipeline look like from now on in terms of new sanctions that you have got?

Prashant Joshi: We actually have fair amount of LTRO 1 as well as LTRO 2 pipeline which is in addition to normal term loans proposal. As things stand even today the discussions for about Rs 500 to 700 crore are ongoing and we expect at least half of them to materialize over the next 30 to 45 days.

Nischint C: How many banks have given you moratorium?

Prashant Joshi: We have received moratorium from three banks, two banks in moratorium 1 and one bank in moratorium 2. Of the total quantum it has not been significant, of all the payments that are due in these three to four months roughly about 10% in value is where we have received moratorium.

Nischint C: What are the payouts in the next six months and what is the cash that is available right now how should we think about your the cash flow position I mean just assuming a situation where possible collection efficiency remains at 30%?

Prashant Joshi: That is what in fact we have projected in slide 14 in our presentation, it gives out what we have. Today we have cash and equivalents of about Rs 2000 crore and we have provided the details.

Nischint C: Okay.

Prashant Joshi: Just look at the repayments, forget the inflows right now and if you look at the total repayment then they add up to about Rs 1700 to 1800 crore. Theoretically even if we are not to have anything at all even then we should be able to service all our debt till March 2021 as Sridhar mentioned.

Nischint C: And these term loans are after moratorium impact or just moratorium impact?

Prashant Joshi: It is really very little and the moratorium also is only up to August whatever little that we have got so really that does not move the needle either ways.

Nischint C: Okay great this was very good explanation thank you.

Prashant Joshi: Thank you.

Moderator: Thank you. As there are no further questions, I will now hand the floor back to the management for closing comments. Over to you Sir!

Amol Joshi: Thank you everyone for your questions. To reiterate the messaging that we have done on the call today, we continue to be extremely watchful in the current situation. Our focus has been and will be to ring-fence the business and provisions we carry are adequate to cover for any future expected losses in the near to medium term. We will continue to deleverage from our wholesale lending business and any liquidity from that is clearly focused on growing our retail business. The cost management focus will continue and we are quite confident that after the equity infusion, we will be able to grab the opportunities that are opening up in the market as things slowly start going towards normalcy. Thank you everyone who joined us on the call today and have a great day. Thank you.

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