Equitas Holdings Limited
Q4FY16 and FY16 Earnings Conference Call
May 09, 2016

Moderator Ladies and Gentlemen, Good Day and Welcome to the Q4FY16 and FY16 Earnings Conference Call of Equitas Holdings Limited. We have with us today P.N. Vasudevan – Managing Director; Bhaskar S – Group Chief Financial Officer, H.K.N. Raghavan – Chief Executive Officer, Equitas Micro Finance Limited; N. Sridharan – Chief Financial Officer, Equitas Micro Finance Limited; Vasudevan S – Chief Financial Officer, Equitas Finance Limited and Mr. Dheeraj Mohan – General Manager, Strategy. 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 '*' and then '0' on your touchtone phone. Please note, this conference is being recorded. At this time I would like to hand the conference over to Mr. P.N. Vasudevan – Managing Director at Equitas Holdings Limited. Thank you and over to you, Sir.

P.N. Vasudevan: On behalf of Equitas Holdings Limited, I welcome you all. We thank each and every one of you for being here on the call with us. This is the first investors call post the listing of shares of the company and hence we would be very happy to welcome your feedbacks which will help us to strengthen our communication process going forward.

I would first give everyone a brief overview of the Group. Equitas is a diversified financial services provider. We are focused on economically weaker individuals who operate small businesses as well as micro and SME businesses. Typically, our clients are people who do not really have very formal documents of income. Hence associating the credit and cash flow always remains a challenge because they find it very difficult to get finance from the formal financing channels. The Group's consolidated performance is majorly contributed by three subsidiaries: Equitas Micro Finance [EMFL], which is in the business of Micro Finance; Equitas Finance [EFL], which is an NBFC and is mainly in the business of used commercial vehicles funding, Micro and Small Enterprise financing and the last is the Equitas Housing Finance [EHFL], which is into the business of affordable housing finance.

Recently, the group had incorporated a new subsidiary called Equitas Technologies Private Limited [ETPL]. This company is creating an electronic platform to bring together people who want to transfer loads and people who have trucks for transporting them. The basic objective of this company is to see whether we could bring them together in a manner which makes it useful for both to operate and transact with each other. This company is in the process of commencing its operation through the portal now and hence we will have more details to share in the following quarters.

As you all may be aware that we have applied to RBI for the final license to convert our subsidiaries into a Small Finance Bank. The merger application for merging all the three subsidiaries viz., EMFL, EHFL with EFL is pending before the Madras High Court. The final hearing is completed and we hope to receive the Court Order shortly after the court vacation. As we transform into a small finance bank, our strategy would essentially revolve around four factors: first, we would continue our focus on the existing lending products and continue to grow the existing range of loan products. We might add a few more products such as agri-backed loan against gold, which is a very relevant banking product, but otherwise the focus would remain on the existing loan products that we currently offer. We already have a pretty good range of loan products catering to the mass segment and so the focus on that should continue as we transform into the bank. Secondly, we would focus on quickly building up the retail liabilities book to the branches, the liability branches that would be setup, and the community banking which we plan to undertake by building a separate channel through the Business Correspondent model. Thirdly, we would also be offering third party products and services such as insurance, pension, demat and trading accounts etc., with which we hope to enhance the value to the clients. And lastly, we would remain very strongly focused on leveraging technology for improving the entire customer experience and customer access to the account through multi-channel sources. We will also continue to focus on technology, for improving the efficiencies of the organization, and on cost reduction along with improving our risk management strategies by employing the best in class technologies.

As you are aware, we do undertake significant activities through our social initiatives. We have a trust called Equitas Development Initiatives Trust, through which we undertake a lot of programs for the benefit of the society from where our clients come from. The micro finance model is very much integrated with the community with whom we work and we have always felt that doing a proactive social intervention in the community is something which goes a long way in creating a good value proposition for our clients. It also helps the community from where they come from. Our medical camps continue to do quite well. We conduct nearly 400 camps per month which benefits about 70,000 to 75,000 people every month. Our training for cottage skills helps our clients to improve their earnings anywhere between Rs.500 to Rs.2,000 per month. About 5,000 people get trained every month and cumulatively we have trained over 400,000. We also conduct lot of job fairs for the unemployed youth and nearly 26,000 were placed last year and till date 60,000 people have been placed. The seven schools that we run have strength of over 4,000 students, who are typically from the low income families. Our entire effort is to try and give them a holistic education which can transform their life of these children as they graduate.

Now I invite Bhaskar, our CFO, to highlight few key financial parameters after which we are open for your questions. Thank you and over to you Bhaskar.

Bhaskar S: Thank you, Vasu. Good afternoon. I will just give brief highlights of the consolidated financials for the quarter and year ended March 31, 2016.

Overall, we had a very good year recording good growth rates across all business segments. The overall AUM as on March 31, 2016 was Rs.6,125 Crore, a growth of 11% as compared to the quarter ended December 31, 2015 and 53% over the same quarter previous year. Micro Finance (MFI) constituted Rs.3,283 Crore, Vehicle Finance (VF) constituted Rs.1,510 Crore, MSE Rs.1,086 Crore and Housing Finance constituted Rs.246 Crore of the total AUM. Compared to last year, MFI grew by 53%, Vehicle finance grew by 28%, MSE grew 112% and housing grew by 37%. For the year, the profit after tax was Rs.167.1 Crore which was a growth of 57% over previous year. For the quarter ended March 31, 2016, the profit after tax was Rs.47 Crore, a growth of 28% YoY and 9% QoQ.

The asset quality parameters also continued to be good with overall GNPA at 1.34% as of March 31, 2016 against 1.08% during the same period last year while it was 1.33% as of December 31, 2015. During the year, the funding profile was more or less similar to last year. It basically constituted the funding from banks by the way of term loans, NCDs for various classes of investors including mutual funds and others, also term loans from some of the overseas institutions. We see the trend for overall funding cost coming down. As far as the current year, it was 11.3% on an average basis compared to 12.07% in FY15.

Our overall credit cost was Rs.59.11 Crore for FY16 compared to Rs.50.43 Crore in FY15. The provision for standard assets out of the overall credit cost was Rs.17.65 crore in FY16 and Rs.10.30 Crore in FY15. So basically the increase from Rs.50.43 Crore to Rs.59.11 Crore of credit cost was largely accounted by increase in the standard asset provision of about Rs.7.35 Crore.

Overall in net terms, the ROE for the year was at 13.31% compared to previous year's 11.15%. So there has been an improvement in ROE driven by improved leverage, operating efficiencies and also the reduction in credit cost. There was a drop to a certain extent on the yields mainly because of the MFI, where we pass on the reduction in cost of funds to the customer which is in line with the RBI requirements on the margin requirement. Hence our margin in Micro Finance was at 9.5% and our yields in the Micro Finance were slightly lower compared to the previous year.

P.N. Vasudevan: Thank you so much, Bhaskar. Now we open for Q&A.

Moderator: Thank you very much Sir. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Sarvesh Gupta from Trivantage Capital.

Sarvesh Gupta: My first question is on MFI segment. I presume that this is basically a fixed trade loan and you said that you are passing on the benefit of lower interest rate to the customer. So can you just elaborate that point a bit?

P.N. Vasudevan: I will request Raghavan, who is the Chief Executive Officer of our Micro Finance Company, to take the question.

H.K.N. Raghavan: In the beginning of April 2015, the interest rate that we were charging was 23.5% and during the year we took a reduction of close to 1.5%. Currently it is 22%. This 1.5% reduction is arising out of predominantly reduced cost in terms of interest rate reduction that we got in terms of borrowing. So that has been passed on to the clients consistently. And what happens is that, as far as interest rate is concerned, it is fixed. In terms of future rate, what is the kind of estimated reduction that is going to take place in terms of borrowing cost is actually factored in and then reduced.

P.N. Vasudevan: So basically giving fixed rate loans, we continue to service the old customers at the rate at which they have taken the loan and the new customers get the benefit of whatever is the rate change, whether it is up or down.

Sarvesh Gupta: So this is a voluntary reduction or mandated as per RBI?

P.N. Vasudevan: Basically, we have a 10% margin cap which is set by RBI. So we have to reduce the rate necessarily when our cost of funds goes down and during each year we have to project what is our cost of funds that is likely to be there over the rest of the year and factor that. We do it somewhere in the beginning to middle of the year as we cannot do it on a month on month basis.

Sarvesh Gupta: Is that is because you are already operating at the margin cap?

P.N. Vasudevan: Yes, typically we operate in the range of 9.5% to 9.75%.

Sarvesh Gupta: Ok Sir. On Equitas Technologies, what is the logic behind floating a technology company when you primarily are a financial services company?

P.N. Vasudevan: See, basically we are in the vehicle financing i.e., used commercial vehicles financing space. Hence we see a lot of leveraging and cross selling opportunities in that space where our clients themselves could come on the platform and if their ability to use vehicle increases, their cash flow increases, which could improve the quality of our loan book. Besides, they could also be a potential customer for our future loans as a bank. So we see a lot of synergy in that and that is where the whole thing has come from. As I said earlier it is just starting to commence operations and we will have lot more details to share as we go by.

Sarvesh Gupta: And Sir my last question is regarding your proposed venture in loan against gold. Now what we have been hearing in the market is that because a large segment of the population is getting loan through Micro Finance where they do not have to put any collateral, which had a negative impact on the loan against gold market. So what are thoughts on the same as you will target the same customer profile? Also, in the environment where everybody else is shedding their gold loan portfolio, you are entering in this market.

P.N. Vasudevan: Yes, see basically we are not doing it as an NBFC because we were not comfortable as an NBFC to try and offer loan against gold earlier. But once we become a bank, this is actually more of a cross sell product for the bank customers, for the liability customers especially in the semi-urban and rural areas. For the bank, this becomes a product which has a lot of response from the client community. That is where the whole thing is coming from.

Sarvesh Gupta: But these will be different customers from your Micro Finance business.

P.N. Vasudevan: Yes, there could be some percentage of common customers but technically it will be really for the liability customers.

Sarvesh Gupta: The reason I was asking is because for the similar interest rate why would somebody want to put up collateral of gold when he can get the loan from Micro Finance without putting any collateral.

P.N. Vasudevan: See, if the customer is a farmer, then that gets classified as a Priority sector loan for the banks. That is one thing. Secondly, there are certain interest subsidies which are offered by Central Government to such clients which are passed on through the bank and the client ultimately benefits. So it is really a banking product that we are looking at and not a loan against gold typically as an NBFC product.

Sarvesh Gupta: And what would be the interest rate that you are planning to charge?

P.N. Vasudevan: So that depends on what are the regulations from time to time. For example, today the regulatory lending rate on loan against gold is about 11% on which it is treated as direct agri exposure on the PSL book and also there is some interest subvention given by the Central Government for such transactions.

Moderator: Thank you. We have the next question from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: Sir, I just had one question on your employee cost. If I look at the consolidated quarterly numbers, the employee cost looks very high for the current quarter. Is there any one-off there or is it something which we should expect going ahead?

P.N. Vasudevan: Besides the normal increases that happen, the employee cost for the current quarter consists of two additional factors. One, there was a provision for bonus on a retrospective effect based on the amendment that recently came in. And second, there has been a certain level of recruitment at the senior levels for the banking operations. So basically these are the two additions otherwise the increase is at the normal levels.

Digant Haria: Could you have a number for the impact because of Payment of Bonus Act?

P.N. Vasudevan: That is about Rs.7 Crore.

Digant Haria: Sir, this would be one-off right? And going ahead you will be making provisions on a regular basis, right?

P.N. Vasudevan: Exactly.

Digant Haria: In the presentation, we keep on mentioning that the equipment finance subsidiary or the commercial vehicles finance subsidiary is on 150-day recognition. But I think all other besides home loan, which is at 90 because it is a home finance subsidy, rest everything is at 150 now. Right?

P.N. Vasudevan: As per RBI guidelines, Micro Finance is at 90 day NPA recognition. Saying that, we have been actually doing it at 30 day recognition from the beginning and it remains at 30 days. Housing is at 90 days as per NHB. So it is only the NBFC which is at 150 days. NBFC consists of mainly two products which are the used commercial vehicles and the micro SME. These two were at 180 till March 2015 and in June 2015 it was changed to 150-day recognition. Hence as of March 2016 that remains at 150. Now going forward, we will have to change that to 120 this year as an NBFC. But if we commence banking operation during this year then we will need to move it to 90 days also.

Digant Haria: Once we become a bank, we will continue to borrow from other banks in the form of IBPCs. Does that attract SLR obligations?

P.N. Vasudevan: Besides refinance from financial institutions, most other borrowings will attract SLR, CRR.

Moderator: Thank you. We have the next question from the line of Mitesh Jain from Investec. Please go ahead.

Mitesh Jain: The Micro Finance loan book has shown strong growth. But we have not seen significant improvement in operating efficiencies. So going forward, any color on OPEX to AUM number, especially in the Micro Finance?

P.N. Vasudevan: So the loan outstanding has grown by around 50% during the year. But our operating cost has only marginally come down from 7.6% to 7.4%. Basically in Micro Finance, this cost of operation can be broken into two. One is the staff cost and the second is the administrative cost. As far as staff cost is concerned, the problem is that there is a certain level of growth which will not change dramatically. In fact more than two-third of the entire operating cost is due to staff costs and it will continue to be reasonably inelastic because of the fact that there is obviously a certain level of growth which is being maintained. On the administrative part of the cost, which is the balance one-third of the total cost, definitely there is lot of benefits which should accrue to the company in terms of scale. So that is something that we should continue to aim at going forward.

During the year, what really happened is that we had opened about 40 new branches. The benefit of that will only come in the subsequent years. So we see that the operating cost should come down and keep coming down over the next two or three years as we keep growing the book. At some time, you may also see some flattening in the operating cost and after that whatever level of AUM growth happens, the operating cost may not change substantially. It is simply because staff cost remains at two-thirds of the entire cost and that is something which is not very elastic. So that is the reality of the Micro Finance model.

The other way to reduce the operating cost is basically in terms of increasing the loan outstanding per client, you give more loans to the same client which will then help you to ~~quickly~~ reduce your operating cost. But it is not only a factor of cost management. It is also an indicator of certain level of risk that is going to be built into the portfolio. We are definitely not comfortable in the risk part of increasing the loan size and hence in terms of our loan size, we remain at the bottom end of the table in the market. That is an added reason, with AUM growth, our operating cost is not dramatically going to come down. In fact, our loan outstanding per client was around Rs.11,250 as of March 2016, the lowest in the entire sector. The next layer of loan outstanding per client maybe in the range of Rs.16,000 - Rs.17,000. So there is a good difference of 40% or so between us and anyone else on the loan amount per client. That is something which we could always take a call to increase the loan size but there is also a risk element in that, which we are not comfortable with. That is why it will typically remain where it is today, which means that you will see our operating margins will remain at very similar levels to what it is today.

Mitesh Jain: Secondly Sir, in the Micro Finance business itself, we have seen slight increase in gross NPA from 0.08% to 0.23%. Anything to read on those numbers or this is just a small number?

H.K.N. Raghavan: The increase has been in sporadic incidences in certain States, especially in the States of Rajasthan and Madhya Pradesh. In Rajasthan, in one of the branches we witnessed our clients from agriculture sector facing major losses due to hailstorm. Also in Madhya Pradesh and Vidarbha, there have been one or two branches where the stress levels on loans have been high. So these are couple of incidents which our branches faced. Otherwise, there was no systemic issue as far as the Micro Finance product is concerned.

Mitesh Jain: Lastly coming to Equitas Finance Limited, we have seen a quite a bit of improvement in cost efficiencies over the last year. But I think there is still significant scope of cost efficiency as loan book growth continues. So what sort of guidance on OPEX to asset will we have in the Equitas Finance Limited?

P.N. Vasudevan: Yes, see this business is very different from Micro Finance. Micro Finance has a very small ticket size with the loans anywhere between Rs.12,000 - Rs.15,000 to Rs.20,000. Beyond a point, the cost becomes very inelastic as I was talking earlier. But in Equitas Finance, the loan sizes of course are very different. The SME loan size is of around Rs. 1.7 lakhs and the average loan size of used commercial vehicle is around Rs. 3.5 lakhs. These are more manageable for cost benefit on scale and that is something that we can see from the presentation we had sent to you. Opex cost has come down from 12% in FY14 to 7.7% in FY15 and down by another 1% to 6.8% in FY16. This is something that we expect to see going forward and it might kind of settle down anywhere in the range of 3% - 3.5% over a period of time.

Moderator: Thank you. We have the next question from the line of Roshan Chutke from ICICI Prudential Asset Management. Please go ahead.

Roshan Chutke: Sir firstly, is there any hiccups that you are likely to face when you do a securitization transaction once you become a SFB? Primarily because the buyer bank is probably interested in only a 10% plus 8% yield loan which you do not have currently on your books?

P.N. Vasudevan: See, once we become a bank we might not be using the securitization route at all because bank to bank the way to transfer a PSL asset is through the IBPC and now of course a new process which is introduced which is a PSL certificate process. So there are two different processes which are lot more efficient and much quicker than the typical NBFC securitization route of either selling the assets or converting into fee income.

Roshan Chutke: And what about now? Do you have any problems in doing a securitization deal before becoming a bank?

Bhaskar S: There is no problem as of now for the MFI book. We can still securitize and the 8% cap is not there. Any MFI, when they securitize a portfolio, it becomes a PSL for the buyer. For the other portfolio, if it is for the PSL purposes, then there is a challenge. But there are banks who are acquiring assets for the non-PSL and for loan growth purposes which will continue.

Roshan Chutke: And what measures are you taking to ramp up deposit base once you become a SFB? Also, how will you contain the cost deposit?

P.N. Vasudevan: See, currently our carrying cost of bank loans on the books is around 12%. Once we start the banking operation, our first and an immediate priority will be to try and mobilize deposits, wholesale and bulk deposits, with which we should try and replace the bank loans and reduce our cost of fund through that process. Once we have done that, in parallel, the entire network of 400 branches which are being setup for the liability branches, that team should really be working in terms of pricing the low cost deposits or retail deposit and CASA which should then replace the wholesale deposit that we would have raised earlier. So that is the whole approach. First step to raise wholesale deposits and close the current bank loans and second step is to try and replace the wholesale deposit with retail and CASA deposits.

Roshan Chutke: Any guidance in terms of numbers here?

P.N. Vasudevan: Right now we have not reached a level of being able to give guidance. But yes, from an approach perspective clearly that is what we will be looking at.

Roshan Chutke: And what is your repossession strategy with respect to vehicles business?

P.N. Vasudevan: See, the repossession is something that is going to continue in terms of what we are doing currently. So we sit and discuss with the customers and wherever we believe that either the customer's intent is not to work or we believe that the vehicle is likely to be separated or something like that, that is when repossession is really resorted to. So that is our stand as far as repossession is concerned.

Moderator: Thank you. We have the next question from the line of Jignesh Shial from Quant Capital. Please go ahead.

Jignesh Shial: Firstly, if I understood it correctly, you said that gold loan yields at close to 11%?

P.N. Vasudevan: Yes, that is the current rate which is given by the banks and they are then classified under the direct agri component.

Jignesh Shial: And you are not much interested in going for the personal gold loans and it will be more linked to the agri gold loans only? Right?

P.N. Vasudevan: We have no interest in growing gold loan as a separate book because that is something which we did consider long time back as NBFC format itself. We were not very enthused with the entire gold loan model and never kind of experimented with it in all these years. It is something which is not our forte.

Jignesh Shial: But overall if the portfolio rises, it will put some pressure on the margins and hence result in decline of our ROE. I am saying specifically on your gold loan portfolio.

P.N. Vasudevan: See, gold loan is something which we will have to study. As we said, it is a good banking product especially for the semi-urban and rural locations. There are certain levels of costs which are already incurred at our branch level like audits, safe vault, CCTV camera, security etc. So we are studying the entire model and seeing whether using the same infrastructure is it possible or for a very small incremental cost are you in a position to rollout a loan against gold, specifically for the agri based customers, and based on that we will take a call.

Jignesh Shial: Secondly, just wanted to understand that once you convert into small finance bank, the cap on that MFI loans will get removed. So you can have even higher or lower rate of interest compared to 9.5% or 9.75% which you are maintaining right now. A 10% cap what we are referring to.

P.N. Vasudevan: Yes, you are right the 10% cap would not apply on SFB and it cannot also apply because as an NBFC today, for example right now out of my 8,000 staff I have just three of them are involved in raising money from the banks. The cost of the funds from the banks is, let's say 12%, the cost of raising that money from the bank is zero because I just got three staff out of a team of 8,000 staff. So my landed cost of loans, landed cost of my borrowing is 12% and then you have a 10% margin cap and so we are lending at 22%. But when we become a bank, the landed cost of the borrowing would include the interest that I pay on the deposits plus also the cost of mobilizing which is going to be very distinctively different from the cost of three staff that we employee today. So this 10% is not applicable and would not apply to a bank.

Jignesh Shial: So any idea what will be your rough cost of funds once we have shifted gradually to SFB?

P.N. Vasudevan: See, as I said right now around 12% is our cost of funds. If you go to other extreme end of the value chain, the cost of funds for the best and biggest of the banks with highest level of CASA is around 5% to 5.5%. Now that is a journey that we have to undertake, from 12% to 5% levels. As we go forward, at every stage, the cost should keep coming down. But the immediate priority of course is to replace the bank loans with wholesale deposits. And as you know, the current deposit rate typically ranges between 8% to 9% depending on the tenure and the entity borrowing. So that is how we should try and work towards the cost, somewhere maybe as a start point and then try and take it down further as we build up our retail liabilities.

Jignesh Shial: Do you intend to pass on whatever the cost, whenever it comes up, to your customers or will wait for a while and try to build up the margins first?

P.N. Vasudevan: See, we will have to look at our landed cost of funds. As explained earlier, the landed cost of fund for a bank is very distinct from a landed cost of fund for NBFC. In NBFC, the landed cost and the interest cost are actually just the same. In a bank, the landed cost is going to be the interest cost plus the cost of mobilizing. The cost of mobilizing as I told you is going to be something like the cost of an IT system that we are putting in place, the cost of our 400 branches that we are going to setup and the cost of the liability team which is going to be added. So these are the things which we have to factor while we fix our lending rate. It is not a question of whether we will pass on the benefit or not, we would definitely like to pass on the maximum benefit to our borrowers at every point in time but it will be done in a manner that is sustainable from an institutional perspective also.

Jignesh Shial: Just lastly, can you just give some more idea on your Equitas Technology part, the company and how you want to setup and all?

P.N. Vasudevan: As we said earlier, it is too early to get into a lot of details on that and we will be in a position to share more information as we go by. Right now it is just a thought process whether we think we can bring lot of value, both to the supplier of load and the transporter who moves it around, and many of the transporters could have a linkage with us. As we maybe funding them for the vehicles, we could also look at funding them on the working capital etc. based on the cash flow they generate. So basically that is the thought from where the whole idea has come from and we will be able to give you much better idea as we go forward and as it takes better shape.

Moderator: Thank you. Our next question is from the line of Bhavin Dave from Reliance Mutual Fund. Please go ahead.

Bhavin Dave: Sir I just wanted to ask you about your MFI business. Can I know the number of customers that we have currently?

H.K.N. Raghavan: As on March end, we had 27.44 lakh clients.

Bhavin Dave: And number of loan officers?

H.K.N. Raghavan: The number of loan officers, sales officers would be roughly around 1,008 and then the collection i.e., the relationship officers would be roughly around 1,500.

Bhavin Dave: And Sir on Equitas Finance business, I am on slide 23 where under the fourth quarter FY16, we see that the deductions have been pretty high as compared to last year fourth quarter. So is it due to recoveries or major write-offs during the quarter in this segment?

Vasudevan S: We have brought down the number of vehicles in stock from 360 in March 2015 to 220 in March 2016. So basically, it was reversal of provision to the extent of vehicles not in stock.

Bhavin Dave: Does that mean that you have managed to get back the money from the customers?

Vasudevan S: No, it is a reversal of provision to the extent of repossessed vehicles not in stock actually.

Bhavin Dave: And Sir again on your MFI business, for one of the earlier question you mentioned that the operating leverage will be not substantial in this business going forward as we are already the most efficient player in the MFI space. So with the 30% - 35% loan growth that we assume for the next couple of years, do we mean that drop in operating expenses would not be substantial in that effect? Is that the way we should look at it?

P.N. Vasudevan: Yes, our operating cost may not come down dramatically. It will only keep going down marginally on a year-on-year basis which also means that our lending rate will also keep coming down marginally due to the operating efficiency. It would go down only because of cost of funds going down but otherwise operating efficiency may not really spur too much of reduction in the opex cost.

Bhavin Dave: So net-net, we will be able to maintain our ROAs in the current range?

P.N. Vasudevan: Yes. As I said earlier, we are not willing to increase the loan size.

Moderator: Thank you. Our next question is from the line of Saurabh Das from Franklin Templeton. Please go ahead.

Saurabh Das: Sir, my first question is essentially going back to that same point which you made that as the bank ramps up, the cost of generating the liability needs to be set off with essentially the spreads. So given that cost will see a ramp up, do we kind of indicate that spreads can move up in the business?

P.N. Vasudevan: As we said earlier, the spread as for an NBFC and the spread of a bank are two different things. In an NBFC, the spread really means the spread between the cost of funds to lending rate and nothing else. In a bank, the spread really talks of the difference between the cost of funds and the lending rate. But the operating cost of the entire liability raising is going to be sitting on the existing operating cost which has to be factored into the lending rate and that would really mean then that the spread would look higher than on an NBFC model, assuming that everything else stays static. So you are right to the extent that technically or very theoretically speaking, the spread might look larger as our cost of funds goes down.

Saurabh Das: And Sir in your opening comments you mentioned about the four point strategy of where the second was about a third-party BC model. So is it more on a liability side or on the MSME franchise buildup?

P.N. Vasudevan: It is more on the liability side. Basically we have signed up with a few insurance companies today and we are also looking at signing up with someone who will enable us to offer a **3 in one** account without us having to get into broking and things like that. So basically the entire thing is from the liability perspective.

Saurabh Das: And these insurance companies, would they have that sort of deep distribution in the areas which you operate or its mostly in the urban pockets?

H.K.N. Raghavan: Currently, the insurance companies have some kind of a model which is Bancassurance as well as their own agent network. But what will happen is that our BC network would be another channel on which the current insurance company can ride. And the insurance companies have kind of a width to actually support even the deep distribution down the rural areas because they will operate as a Hub and Spoke model.

Saurabh Das: And Sir just again toggling back to the first point on the spreads, so is there some sort of a yield threshold which you have currently in mind below which you would not get into those products expect for the PSL requirement which you mentioned about agri gold loans. For instance, is there a certain segment where even if you kind of get an opportunity to grow on the segment, you would not like it because it is not meeting your spread threshold criteria?

P.N. Vasudevan: Yes absolutely. Right now if you look at our main products, Micro Finance, used commercial vehicles and MSE finance one is that they have been growing well. Second, if you see from the market based on various government estimates and service that are there in the public space, the kind of unserved demand from this segment is still very large. So we have a large opportunity in terms of continuing to look for growth within this space that we currently are in and have built certain level of capability to manage this kind of businesses. So we are not in a position where we are desperately seeking to diversify into ten other products to sustain our growth rates. Any decision that we take to diversify and introduce any new product would necessarily have to go through and confirm our requirements in terms of some factors such as whether the market is large enough, whether we have the capability to manage and deliver in those markets, whether we have capability to bring value to the customers and finally whether the products will meet certain yield requirements that we have as a minimum threshold for them to cross. So we are not in a desperate situation of having to diversify at all and hence obviously anything that we do will be very clearly planned.

Saurabh Das: And on the micro SME side, are you also planning to get into unsecured micro SME loans or these would be all secured with land and collateral?

P.N. Vasudevan: Right now all of them are collateralised by house property. Going forward as we become a bank, we will be looking at it, because the relationship of a bank with the customer is completely different from the relationship of an NBFC with a customer. Especially a small enterprise customers with whom you start up, fundamentally by having its current account with you and you can set certain triggers in your system by which you define what is its likely daily turnover and then the system can monitor whether that level of minimum amount is being deposited into that account on a daily basis and within a day or two you know whether that customer is doing his business in a normal manner or not. If it is not coming in at the defined level, it can cause triggers and people can go to the shop and see what is happening really there. So your ability to respond, ability to monitor is very dramatically different once we become a bank. Once you get that capability then you may always be able to trade off certain level of collateral security for the extra capability to monitor that you get on those accounts. So these are things which we can do once we become a bank but right now it is wholly collateralised.

Saurabh Das: And just on the MFI space itself, after a lot of MFI is converted into banks and they also have certain cost which they have to manage just like yours, are you seeing pricing discipline to sustain or do you see some of them actually in the quest for growth compromising on either processes or in terms of yields?

H.K.N. Raghavan: I think it is very difficult for us to comment on how the other companies will actually pan out in terms of strategy. As far as Equitas is concerned, we will continue to strive in terms of efficiencies and as mentioned earlier it is important that we pass on the benefit of lower cost to customers wherever it is possible. And third most important thing, in this particular segment, the lender has to be completely responsible for client protection. So when you are talking about client protection, the ticket size is also very-very important in terms of what extent you are about to leverage the client. That is why we are talking about managing this particular ticket size at a particular level. Beyond which it would probably increasing the leverage we are not looking at that particular strategy.

Saurabh Das: And just on the liability piece, while you did mention your strategy about moving from the current bank loans to bulk deposits, if you can share some initial progress in that in case you are already starting that journey, what sort of rates are you getting on the bulk market? That would kind of help us.

P.N. Vasudevan: Maybe next quarter or subsequent quarter, we will be able in a position to give you much better information.

Moderator: Thank you. Our next question is from the line of Hiren Dasani from Goldman Sachs. Please go ahead.

Hiren Dasani: A question on the Micro Finance asset quality. I understand that we are doing our job correctly but as I think some of these other participants have highlighted the industry is growing quite fast and there is also added concern that some of the MFIs which are now converted into banks, like yourself, may not need to share the data with the credit bureaus and all. So what are your thoughts about this issue?

H.K.N. Raghavan: As far as the sharing of information to the credit bureau, as per the RBI guidelines it is now mandatory to be inform all the four credit bureaus. In terms of small finance bank, converting Micro Finance as part of our process of getting into small finance bank, we are coordinating with the MFIN, which is our association and broadly the SFBs have agreed to kind of contribute the data which is actually a positive step. And second in terms of growth, yes growth per se it is not bad but I think the quality of growth is very-very important. The MFIN association is also seized with this matter. I think there is a lot of awareness that is being created among the MFIs and MFIN is also taking steps to get all the members on board in terms of quality of growth so that the sector continues to be healthy.

Hiren Dasani: And Sir one question on the banking conversion guideline, are we operating as a bank already or we are still waiting for some approval?

P.N. Vasudevan: No, we have applied for final license a couple of weeks back. Once that comes and the merger of the three subsidiaries takes place, there is a host of other licenses we need from different departments of RBI. As and when we get all them, we would be in a position to convert into a bank and start operation.

Hiren Dasani: So realistically speaking, another six months before we start seeing operations?

P.N. Vasudevan: Surely.

Hiren Dasani: And then there is also the question of merger of the Holdco with the bank, right?

P.N. Vasudevan: No, that is not a thing that is being done right now. Just to give you a little bit of the background which we had given in our Prospectus during the IPO, right now we have the Holdco and we have the three operating subsidiaries. The three operating subsidiaries are being merged once we get orders from the High Court. Once we have all the licenses in place, the merged subsidiary will be one which will commence operation as a bank. The Holdco will remain as a Holdco and the bank will be 100% owned subsidiary of the Holdco. Now we have another norm of RBI which is that the bank must be listed within three years of commencing operations. So once we start operations, from then within a three-year period, we are supposed to list the bank. That is what we had mentioned in our application to RBI and also in our IPO Prospectus. At the time when the bank is required to be separately listed, we will approach RBI for reverse merging the bank with the Holdco so that we will have only one listed entity doing business. The same thing was mentioned in the Prospectus.

Hiren Dasani: So effectively we will have to do that application or representation to RBI when the time is there to list the bank?

P.N. Vasudevan: Absolutely, that is at a later point in time.

Hiren Dasani: And Sir just one last question on the banking model profitability. I understand that once you convert into the banks, there will be certain costs to be incurred and all. What is your sense about, after let's say incurring all those costs, respectable mid-teens kind of an ROE profile? Should we think of it as a three year, five year or even longer?

P.N. Vasudevan: As I mentioned earlier during the call, we are not in a position to give guidance at this point in time. But basically what we have mentioned in the Prospectus is that the focus will be on asset growth and closing the bank loans. We will seek to replace bank loans with wholesale deposits initially and then retail deposits. And these processes will have a certain level of cost elements, which will be an additional cost as we convert to a bank. And secondly, it will have an additional opportunity, in terms of ability to raise deposits at a rate lower than the bank rate. The playoff between this benefit and the cost would really determine where ROAs and ROEs will remain. Also the fact that we are fairly leveraged at a low level today around three times and as we go forward, the more we are able to leverage on that would be another boost from an ROE perspective. So that is where we are but I am really sorry that at this point in time we are not able to give any guidance in terms of the ROE.

Moderator: Thank you. We have the next question from the line of Praful Kumar from MSD Partners. Please go ahead.

Praful Kumar: Just wanted to check in terms of the liability side. Given the fact that this will be very low balance accounts, what is your strategy in terms of getting those accounts and servicing cost of those accounts? So in terms of rolling out ATMs and issuing debit cards, what is your strategy on the liability side?

P.N. Vasudevan: See, there are various type of accounts which we plan to have. One is the basic savings bank account, an RBI defined product. That is something where there is no flexibility for any bank. So that is something that we will have in the kitty and that is something which will be rolled out. Second thing is one that is outside of that. Obviously the product designing is within the hands of each bank, so we would be looking at few types of accounts. One is an account where the savings balance is at the lowest level, let's say Rs.1,000 or a Rs.2,000 balance account. Now in this kind of really small value balance account, you cannot really afford to spend a lot of money in terms of servicing. Just to give you an example, if you have let's say a Rs.1,000 account, then the interest benefit you pay probably 4% or 4.5% on the savings account and the benefit that you get on transfer pricing from that particular savings account, let's say even a 3% if you are willing to benefit, then you are earning something like Rs.30 in a year from that account which is our gross income. From there you will have to spend some money for the technology, for managing the account on your system etc., which is approximately Rs.5. So you talk of Rs.25 at the gross level net of technology cost. Now if this customer is going to swipe the ATM card, let's say even just one time a month and not even more than that, that is Rs.15 a month into 12 is Rs.180 and this Rs.180 is 18% of the Rs.1,000 balance that he is holding in the account plus 4% interest at the end. So he becomes a 22% cost of fund for you which is an impossibility. Obviously, nobody can manage or nobody can survive on that kind of economics. For some of these really low balance accounts, we would not give them a card because a card can become an absolute impossibility to manage. But we will allow them multiple accesses to their account outside of a card. Of course coming to the branch is always an option. Besides, appointing BC's, Business Correspondents, is another option. There is a lot of work going on the BC model which we had clearly highlighted in our Prospectus. BC is nothing but a community banker who we will take someone from the local community, appoint him as a BC and in a shop, he puts up a kiosk and that becomes a bank counter. People within that area, within let's say one kilometer radius, should be able to transact with them over the counter. So the customer should have an ability to put in and take out very small value transactions but at a cost level that is bearable for the client as well as for the bank. There is lot of stuff like this that we are working on and as we launch the bank definitely, there has to be lot of innovations which needs to be done. Ultimately you want the customer to have easy access to his account and then how do you provide that easy access, in a manner which is still sustainable for us. So that is a whole innovation that is being worked on and lot of effort going on in that direction.

Praful Kumar: Can you give us the yields that you charge on the products that we have in terms of used UCV, MSME, what is the yields we are charging?

P.N. Vasudevan: So Micro Finance is at 22% currently, used commercial vehicles ranges from about 18% to 22% depending on the customer profile and MSE also ranges from 17% - 17.5% and goes all the way up to about 22% - 23%, again depending on various credit and other profile parameters**.**

Moderator: Thank you. We have the next question from the line of G. Vivek from GS Investments. Please go ahead.

G. Vivek: I wanted to know about the risk management capabilities of our banks, number one. And number two, why our return ratios are slightly lower than that of other MFIs operating?

P.N. Vasudevan: On the risk management capability, basically as an NBFC our principle risk is credit risk and operation risk. Market risk and interest rate risk - these are all not very significant because most of our borrowings with the banks are back to back tenure match with lending. Credit risk is something wherein we have put in huge amount of effort. We have put in a team which can do a field based credit assessment and cash flow assessment and servicing capability of customers based on the fact that they still have very informal income coming in and also multiple sources of income coming in. So we have put in a very rigorous system of credit appraisal including lot of collaboration through other sources and channels. For example, let's say if somebody is running a small eatery or a restaurant, then we determine what the sales turnover that he is seeing, how much of food he is cooking in a day and for cooking that level of food how many gas cylinders are likely to be used. Then we go to the agency which is actually supplying gas cylinder to that eatery and then we see their records and see over the last three months on an average every day how many cylinders are being supplied. So there are lot of such efforts we actually put in credit assessment of these kind of segment of people and over time, I think we have done a lot of effort to ensure that we have a very tight credit appraisal process in place and ultimately the credit appraisal is reflected in the portfolio quality and touchwood our quality of book has been pretty good over the last few years thus giving us a lot of comfort to look at growth on a sustainable basis. That is on credit risk. Operations risk, again since we deal with the customers who do not have too many choices in their life, so they are easy prey for the company and the employees. The company can charge them whatever we like because frankly they do not have too many options outside of us. For example in the used commercial vehicles, for 80% of our customers, we are the only financier to them. In MSME, almost like 100% of the customers, we are the only financier to them. So they are to that extent vulnerable in that sense and apparently we always have a stronger hand in dealing with them. These are very significant operating risks because they will affect the entire reputation of the organization which can result in severe crises at some point in time in the future. So we have put in a lot of mechanism to manage the operations risk. On the company side, of course the word Equitas, a Latin word, which is equitable, means being fair and transparent. So right from day one, we realised that this company is eternally going to be dealing with customers who are always going to be on a very weak footing in relation to the company. So we sat around and said that this company in all its transactions with its clients shall always be fair and totally transparent and that is where the word Equitas was given for the company to reflect the theme, philosophy of this organization right in the name of the organization itself. And this is not an empty slogan, this is not something that we just print and stick on the walls of our reception and offices etc, but this is something that we actually live by. We have lot of demonstrated examples where the company has been very fair in its transaction with its clients and the interest rate that we charge. For example, the first loan that we gave in December 2007 was 25.5%, all inclusive lending rate to Micro Finance customers at a time when the market rates were anywhere between 35% to 45%. And four years later, when RBI came with a regulatory lending rate cap of 26%, 0.5% more than what we had been charging all those years. So we have demonstrated this desire to be extremely fair to our clients' right from day one. That is something that we will continue and as long as we hold that philosophy, we hope that we will always have a very strong reputation, be it from our clients or from the regulators or from anybody else. The other thing is operating risk on the field side. To avoid our staff misbehaving with the clients and not dealing with them in a fair manner, we have put in very tight operating controls on the processes happening in the field. We have what we call as Equitas Chakravyuh. Equitas Chakravyuh really represents seven layers of concentric risk management circles over every single transaction which happens at the field level. So whatever transaction our staff does with the client, it is supervised and monitored by seven different people at seven different points in time on seven different sampling bases. And so if a person wants to cheat our clients, they will have to ensure that they escape every one of the circles of controller rings of control and then he can get out of the system which is many in place. But that is very difficult and it's quite impossible for anybody to cheat. And so over the last eight years, in the markets where they are very much prone to frauds, cash management frauds and cash risk frauds, we have had extremely few frauds. So that is how we control our operating risk and the credit risk.

G. Vivek: The second query was about our return ratios been slightly lower than that of our competitors, is that a deliberate strategy? And thirdly about the opportunity size and impact these credit bureaus are having on Micro Finance industry as a whole?

P.N. Vasudevan: I will not comment about our competitors. But if you look at our ROA for the year ending March 2016, our consolidated ROA is around 3.05%, which I think is a decent ROA and our ROE is around 13.3%. ROE is something that we also have to look at in combination with our leveraging which is around 3x or 3.2x. So, apparently on the face of it, our business model is very much in place generating a sufficient healthy ROA and as we leverage the equity further, over the next few years, hopefully the ROE should keep improving.

From an opportunity perspective, Micro Finance is still a very large demand area to supply in spite of reasonably large growth, the sector has seen during the last few years. The percentage of demand serviced is still not very high. So there is definitely a large opportunity in terms of growth for Micro Finance companies, but as Raghavan explained earlier, the growth has to be combined with lots of prudent field level practices to ensure that it is sustainable. Credit bureaus, yes they have played a very stellar role. Maybe I will just ask Raghavan to explain the benefits that we have been able to derive from the credit bureau.

H.K.N. Raghavan: I think credit bureaus as Vasu said there has been fantastic role they have played and combined there are 70 million clients as of now with the credit bureau on whom you get information on that. And credit bureaus over a period of time are refining their ability to assess the clients in terms of their leveraging. For example, today in entire Micro Finance sector, there is not even a single loan that has been disbursed without a credit bureau check, i.e. the credit information report. More or less, I think this also ensures that we don't over leverage the client or at least we have a prima facie evidence as to what extent is the client currently leveraged. It helps us to mitigate a lot of risks in terms of credit risk. You can choose to lend or not to lend based on the exposures the client has got as of now. And further, with the Aadhaar seeding which has started it helps us to ensure that we can have a common ID so that the detection becomes much better than what it is currently.

G. Vivek: So without the PAN Card and without Aadhaar, how are these credit bureaus performing? Because most of the above customers would not be having PAN Cards and Aadhaar was not all allowed as per Supreme Court ruling and directive?

H.K.N. Raghavan: See, the credit bureau started its operations in April 2011 and at that point of time there were different KYCs for clients. Whatever KYC that was mandated by the RBI was used. Number one is your voter ID card, second is your ration card, third driving license or bank account. Over a period of time, the credit bureaus have also refined their search in terms of phonetic names, client name and husband name combination followed with the pin code without even all these KYC numbers, common numbers. Now they have an ability to detect the client's loan close to 85% - 90%. And further with the Aadhaar and Voter ID coming in, it further improves the ability to find out the loans of the clients much better than what it was before. But otherwise the credit bureaus never started on one reference point.

G. Vivek: So it remains that an average retail Indian borrower is far more honest and responsible than say the corporate stress being faced by a lot of wholesale banks?

H.K.N. Raghavan: I think that is for you people to decide. To be very frank, the kind of repayment in Micro Finance, there are evidences as to how the repayments are much better than any other segment. And number two, what is important is that, credit bureau whenever we cross-check with the field; more or less 90% of strike rate is good.

G. Vivek: And any plan of spreading into newer geographies like UP, Bihar and North where the saturation level is much less?

H.K.N. Raghavan: I think given the number of products that we have and the coverage that we have, I think we can currently leverage our distribution within the Micro Finance and also apart from other products, so hence the potential in the existing States are quite good enough but as and when we move on, when we find that the opportunity is there in other States and current States are being kind of penetrated much better in terms of products, because there are housing products, there are loan against property products, there are SME products, a lot of opportunity is there in the unbanked segment in these existing States itself. I think progressively we will look at it whenever we find that we need to move to the next level or the next States.

Moderator: Thank you. We have the next question from the line of Pritesh Vora from Incedo. Please go ahead.

Pritesh Vora: My first question is, when you convert to SFB, what kind of operational structure you will put in? Whether you will have a separate liability management team, separate offices? Can you give some detail around that?

H.K.N. Raghavan: As you are aware we have close to 2.2 million to 2.8 million clients with whom we have relationship either on a fortnightly basis or on a monthly basis, we are visiting them for doorstep collections of installments. So what happens is that we will leverage this particular distribution because there is no additional cost. The relationship manager who is going to these clients will automatically go there and then see how we can improve in terms of their savings. Second is that, within this particular profile of clients where we do not have that kind of a penetration or there is large number of another probably say 60% to 70% of clients where we do not have current relationship with them, here we will use extensively the BC model to ensure that we get into opening accounts and then get them to savings on that. And as far as the general branch banking is concerned, we will basically put up branches where the existing asset team will be there. The branch manager and their team will actually start sourcing the savings.

Pritesh Vora: What sort of percentage you will get from the new branches and new organization and what percentage of liability will come from that?

P.N. Vasudevan: You are talking about the assets?

Pritesh Vora: I am talking about overall liabilities, you have asset already now, you have to create a liability franchise basically so will it come from presently, what percentage of liability will come from the existing assets asset side and what percentage of liability will come from new branches, new organization structural you put across?

P.N. Vasudevan: Over a period of time, we would expect around 30% to 35% contribution from the existing asset client and the balance would be contributed with the branch banking.

Pritesh Vora: And what sort of cost, when you go for balance 60% - 65% from balance bank branches, will come up due to these new branches?

P.N. Vasudevan: This is something again we have discussed in elaborate detail earlier and as I mentioned earlier we are not right now giving any forward number or guidance on this issue. So short of giving any numbers or giving any kind of an indicative figure, just want to say that there is a certain level of cost which will incur, certain level of advantages which will accrue and our effort will be obviously to play it out one against the other to try and minimise the impact.

Pritesh Vora: Three years down the line, you will propose to RBI to allow reverse merger. What is the present rule? Do we have to separately list this bank as per the present guidelines of RBI or RBI will be flexible to reverse merge this into bank?

P.N. Vasudevan: The present guideline is that at the end of the third year the bank should get listed separately. But we will be approaching them for reverse merger as and when the time comes up. See right now, the holding company is the promoter of the bank. So when we reverse merge, the promoter will cease to exist. That is basically the impact otherwise there is no other impact for which we need RBI approval. And if you see the SFB guidelines which were issued long back by RBI, more than a year and half back they had invited questions from the public, and if you go to response to clarification # 101 of that particular RBI release, there somebody had a question that at the end of five years if a promoter wants to exit a SFB bank, would that be permitted? The RBI said that it will be subject to RBI's regulatory comfort at that point in time. This obviously means that, assuming they have comfort then, they might consider letting the promoter move on from the bank. And in our case, when we reverse merge, basically that's what will happen when the promoter entity will go. So when the time comes, we will apply and hopefully RBI will look at it and if we have been able to get a good level of comfort created with RBI over the next few years then maybe the approval should come through.

Moderator: Thank you. Our next question is from the line of Rahul Ranade from Goldman Sachs Asset Management. Please go ahead.

Rahul Ranade: Would it be possible to get a breakup of GNPA and net NPA for the vehicle finance and SME piece separately?

P.N. Vasudevan: I will ask Vasu, CFO of NBFC to give the details.

Vasudevan S: As of March 16, GNPA of vehicle finance was 3.36% and MSE was 0.62%. NNPA for vehicle finance and MSE was 2.42% and 0.55% respectively.

Rahul Ranade: The next question basically comes from an observation of slide 23 on provisions and write-offs, if you look at FY16 and FY15, in both the years in Equitas Finance column, a lot of the credit cost actually comes from realised losses rather than provisions. So do we have any provision coverage ratio in mind which we would want to reach or would it be kind of a derived number where we just follow RBI guidelines on that?

P.N. Vasudevan: Right now as per RBI norms, based on our portfolio quality, we need to have provisions of around 13% - 14% but we are at about 26% - 27% of total coverage. And going forward, we should always be above the RBI requirement, but I am not in a position to say how much it will be. But definitely we are already at 26% - 27% and it should keep going up, may be 35% - 40% at some point of time.

Rahul Ranade: Do we have any individual lending in the Micro Finance space to our seasoned customers or is it wholly group lending model?

P.N. Vasudevan: There is no individual loans, it is a group model completely.

Moderator: Thank you. We have the next question from the line of Suhani Doshi' from Edelweiss. Please go ahead.

Suhani Doshi: Can I get guidance on the branch expansion in the coming years?

P.N. Vasudevan: Currently we have around 530 or 540-odd branches and around 400 of them will be converted into liability. The remaining will be run as asset branches.

Moderator: Thank you. Ladies and Gentlemen, that was our last question. I would now like to hand over the floor to Mr. P.N. Vasudevan for closing comments. Over to you, Sir.

P.N. Vasudevan: On behalf of Equitas Holding Limited, I thank you all for participating in the call today. This was the first analyst call for us at Equitas and it is a great learning experience for us. Thank you so much for educating us and asking all kinds of questions. I do not know whether we were able to give satisfactory replies to all of your queries, but we will study your questions and the trends, and maybe next time around, we might be better prepared to talk more lucidly in terms of whatever questions you ask. Thank you very much and look forward to seeing all of you again. Thank you.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, on behalf of Equitas Holdings Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.