Equitas Holdings Limited

Q1FY17 Earnings Conference Call

July 25, 2016

Moderator: Call of Equitas Holding Limited. From the company, we have with us, PN Vasudevan – Managing Director; Bhaskar S – Group Chief Financial Officer; HKN Raghavan – Chief Executive Officer, Equitas Micro Finance Limited; Murthy VS – Chief Executive Officer, Equitas Finance Limited; Sridharan N – Chief Financial Officer, Equitas Micro Finance Limited; Vasudevan S – Chief Financial Officer, Equitas Finance Limited; 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 telephone. Please note that this conference is being recorded. At this time, I would now like to hand the conference over to Mr. PN Vasudevan, Managing Director at Equitas Holding Limited. Thank you and over to you sir.

PN Vasudevan: Good evening and welcome to the call. Before Bhaskar takes you through the quarterly numbers in detail, I shall give you a quick overview of our performance and dwell a bit on each of the business. Post that, we will take your questions.

We had a reasonable performance this quarter. PAT for the quarter was Rs.61.2 Crore, registering a YoY growth of 63.6% and a QoQ growth of 30.8%. Net Interest Income stood at Rs.190 Crore, YoY growth of 51.6% and a QoQ growth of 16.9%. The total AUM at the end of the quarter stands at Rs.6,559 Crore, with a YoY growth of 48%.

GNPA after considering the shift from 150 days to 120 days NPA recognition stood at 1.61% compared to 1.34% as of March 16. As we transform into a bank, we will move to a 90 days NPA recognition which translates to a GNPA of 2.2% at current levels. The current provision coverage ratio of 29% will adjust to 26%, as per Bank norms.

As of June'16 position, if we do the provision computation as per banking norms, we have an excess provision of Rs.36.8 Crore. The Board would need to decide how to handle this available excess provision in the system. If the Board decides to use this to improve the PCR, then the PCR would move up to about 45% to 50%.

Now moving to individual businesses. Our Micro Finance business continues to show a healthy growth, the AUM and disbursement registered a YoY growth of 48% and 29% respectively. Tamil Nadu contributes 60% of our disbursement, was 70% over a year back and the same is expected to come down as newer branches in other States catch up.

However, we are concerned with over-leveraging by clients in certain pockets and more so given that 70% of the MFI market comprising of eight SFBs & Bandhan will move away from the two MFI per client norm shortly. To mitigate this risk, there is some discussion amongst the industry players to see whether loans from Banks can also be counted for the purpose of this two MFI rule. However, the progress is slow.

Internally in Equitas, we are already following this norm. This results in pretty low ratio of clients moving from one cycle loan to the next rather low, may be the lowest in the industry. While it may seem that this would impact our growth and also our cost, yet we believe from a client over-leveraging perspective, this is a right approach to take.

Coming to the UCV or Used Commercial Vehicle finance, the industry has picked up and there has been growth in the sales of new vehicles. This has translated into an increased comfort in customer repayment and utilisation of trucks than a couple of years back. Our portfolio is doing well, giving us the comfort to focus on growth. From about 140 branches, we are expanding to about 180 branches during the current year.

The Micro & Small Enterprise financing [MSE] continues to grow steadily. This is basically a cross-sell product to the top end of the MFI customers. 75% of the book comprises of Micro loans to existing MFI customers while the balance is to non-MFI customers. The 36 bps spike (0.98 bps in Q1FY17 vs. 0.62 bps in Q4FY16) in NPA to 0.98% is mainly due to the change in NPA recognition from 150 days to 120 days.

The Housing Finance is a small piece and contributes around 4%. It operates only out of 16 branches. Though there is a spike in the NPA in this portfolio, the overall quantum of NPA is small and is contributed principally by a few larger value accounts, which will be addressed shortly. We see good potential for affordable housing finance going forward and expect that our bank branch network of around 400 should be a good sourcing center for the same. We are looking to set this up as a focused vertical to pursue this opportunity.

Coming to Equitas Technology Private Limited (ETPL), it operates a technology-led freight aggregation under the brand 'WowTruck'. The technology platform is under construction and we expect Phase 1 to be ready by this quarter-end. Currently, off-line assisted transactions are being carried out. Once the platform is ready, we expect to move to on-line and less assisted form of transaction.

After having received the approval for Amalgamation from the High Court of Madras on 6th June and the final RBI license on 30th of June, the preparation for the launch of the bank is on in full swing. Subject to getting various other required approvals in time, we hope to launch the Bank on 5th September 2016, which is Ganesh Chathurthi day.

We have currently about 580 branches overall. We have received the approval to open 412 bank branches. In these 412 locations, the current lending branches would continue to function as it is, at its present location & cost. The liability branches would be set up within close proximity to these asset branches, with better visibility and therefore, higher cost. We have applied to RBI for permission to continue the remaining about 180 branches as Asset Only branches and are awaiting their approval.

As a bank, we would be introducing Agri Gold Loans in our semi-urban and rural branches specifically and Business Loans to commercial establishment in the neighbourhood of our bank branches. We have already piloted Business loans in a few locations. With these two new products, we believe we would have a complete range of loan products for the retail customer segment.

Last but not the least, our social initiatives continue to be very focussed. For a Company, which works very closely with the lower income segment, it is important that we completely align with the society in which we carry out our business relationship. It is critical that in our model, we believe that integrating our CSR activity within the areas we operate is very critical from a sustainable perspective. We do make a 5% contribution from the profit to the Trust to carry out all our CSR activities.

This quarter our health camps have benefited close to 1.9 lakh lives and cumulatively over 4 million people. Our skill training program which is a 15 hour five day program, has benefited over 4 lakh people and our job fairs have helped place over 65,000 unemployed youth into various jobs.

I am happy to inform that Equitas Birds Nest, a pavement dwellers rehabilitation programme, has successfully rehabilitated 800 families. After our initial support by way of paying their rent for 6 months, and skilling them to improve their income levels, these families are now self-sustainable and are paying the rent on their own from the seventh month. Out of these families, 12 children had passed out 10th Std exam against all odds this year. We had a function in our office last week to felicitate them and with the help of charitable organisations, we were able to mobilise enough resources to provide all these children with full scholarship for their higher education.

Finally the 7 schools we run in different parts of Tamil Nadu for the children from the lower income sections of the economy saw its first batch of 23 students from the first 2 schools appear for their 10th standard board exam. I am happy to share that we have not only managed to secure 100% results but the school average marks was 84%. The two toppers scored 96% each. It was a wonderful effort by the students, parents and the teachers who took upon themselves the full responsibility of making up for the lack of home support for these children.

Now I hand over to Bhaskar to take us through the financials.

Bhaskar S: I now give the highlight of the financial performance for the quarter ended June 16. The overall AUM was at Rs.6,559 crore as of June 16, 48.4% higher than June '15 and 7.1% higher than March'16.

Looking at the business-wise AUM, 52.5% is from MFI which is Rs.3,442 crore, 24.6% is from UCV which is Rs.1,614 crore, almost 19% is from MSE which is Rs.1,246 crore and Housing consists of around 3.9% which is Rs.257 crore. The overall AUM growth YoY was 48.4% wherein MFI grew by 48.4%, UCV by 29.2%, MSE by 89.8% and housing 32.3%. The 'off-book' was 13% of the total AUM, which was basically securitized assets and assets under management.

PAT for the first quarter stood at Rs.61.2 crore. This is 64% growth YoY and the 31% growth QoQ.

The asset quality parameters also continue to be good. As of June 16, overall GNPA was at 1.61% as against 1.34% as of March 16. As Vasu mentioned earlier, during this quarter we moved to 120 days NPA recognition in EFL as per RBI requirements from earlier norms of 150 days. This is the main reason for the increase of GNPA to 1.61% from 1.34%.

The Net Interest Income was at Rs.190.3 crore, growth of 51.6% YoY and 16.9% QoQ. The growth was on account of the equity infusion and also due to the growth in the overall AUM and some reduction in the cost of borrowings.

The Operating expense [Opex] was at Rs.113.4 crore, 51.7% higher on YoY basis and 8% QoQ. The part of the increase was also due to the expenses which we're incurring towards the setting up of the bank.

Credit cost at Rs.17.6 Cr was 6.8% higher on YoY and 20.2% QoQ. This is after the 120 days recognition of NPA for EFL. ROA was at 3.69% in Q1FY17 compared to 3.30% for Q1FY16. Gearing was at 2.85 times. With higher ROA, ROE improved to 14.21% compared with 12.57% for Q1FY16 and 13.31% for FY16.

As on date, we have fully utilized the IPO funds with Rs.616 crore invested in subsidiaries, Rs.288 crore each in EFL & EMFL and Rs.40 crore in EHFL. The balance amount was utilized for general corporate purposes after setting off the expenses on the Issue.

I would like to take the opportunity to also mention that during the last board meeting, Dr. Parthasarathi Shome has joined us as an Independent Director of the Board. Dr. Shome is Chairman, International Tax Research and Analysis Foundation and is also a member of the Audit Advisory Board, Comptroller & Audit General of India.

With this, we open the floor for your questions.

Moderator: Ladies and gentlemen, in order to ensure that the management is able to address questions from all the participants in the conference, please limit your questions to two per participant. The first question is from the line of Parag Jariwala from Religare Capital. Please go ahead.

Parag Jariwala: Basically, you highlighted that in Micro Finance because of new small finance banks starting the operations, the rule of two customers per MFI may not be followed universally and there will be problems. In your opening remarks, you said that now since 70% of the MFIs are becoming SFBs and the two per borrower limits apply only to NBFCs, so there may be some overlap which may worry you. But is there any other worry apart from this? Like probably your ticket size, let's say it is Rs.18,000 to 20,000. If you bucket it, then some of them may be getting Rs.40,000 or 50,000 as well. So do you see a reason not to give more loans to these people because they don't have income which can support higher ticket size? Is there also such issue or it's only a rule which makes you worry more?

PN Vasudevan: As per the RBI guidelines, we can lend up to Rs.1 lakh per borrower. Within the industry, we have a code of conduct, where we have said that for two MFIs, both loans put together, should not exceed Rs.60,000. So there is some level of an internal code of conduct in terms of the quantum of exposure per customer. So from that exposure per customer perspective, I guess that's comfortable. But the point is whether that applies to only the MFIs or would it also apply to the bank and the MFIs. It is the only issue. So far all the MFIs have been funding the last 4 years. It's been quite fine and the market has been very sustainable because the customers have not really been over-leveraged. The credit bureau data has been pretty good and so we have very reasonably accurate information of borrowings of any individual in the market. With a combination of two MFI rule, cap on the quantum of loans and the credit bureau database really has ensured that we have really put the over-leveraging behind us. But now what has happened is, few of the private sector banks have started doing Micro Finance loans through what is called the BC model. So they are appointing few of the MFIs as a BC and they are also funding. While it was not a worry so far, but their size is beginning to increase now. As the size of exposure increases in the industry, we expect that it will become a worry at some point in time.

Second thing is that, 70% - I mean MFI constituting 70% of the market when they become a bank and if they are not counted for the two MFI norm, then that means that their customer may end up borrowing from two MFIs plus some of the SFBs plus some of the other banks doing through the BC. Then you do not know where exactly they are going to stop and at what level the leveraging will stop. Being unsecured, you are always worried of over-leveraging. In the Micro Finance loan, typically the loan size being so small and the numbers are increasing. Actually, as a lender, we do not really do complete cash flow assessment at an individual level. We do a lot of verification of KYC, we do a lot of verification of the source of income, the business and also the group bonding and group solidarity. All that is put through a lot of vigorous tests. But the one thing we do not do is individual cash flow assessment at an individual or a family level. In the absence of that, then you always want to have some kind of overall cap on exposure to make it comfortable and that is where we are saying that you know the two MFI norm, is it really expanded to include, not just to MFI, but to any formal institution, be it bank or MFI. That would then bring it back to the same sustainable norm that we have had in the last 4 to 5 years.

Parag Jariwala: Can you just highlight couple of States or Regions where you see such problems being more prevalent?

PN Vasudevan: Well, it is not really very State or Region specific, because if you see in every State in India, somebody or other is fairly dominant. If you take West Bengal, Bandhan and Ujjivan are very strong. If you take Tamil Nadu, Bandhan may not be here, but Equitas is there. Janalakshmi is also there and so is Ujjivan. In Maharashtra, you have Suryoday which is one of the eight SFBs, has a strong presence. We are also there along with Ujjivan. So like this, in each State, you see somebody or the other is there. Hence it is not so much region specific, it is more a norm specific I would say.

Parag Jariwala: Lastly in terms of your expenses to transit yourself into a bank, is that anything which you have incurred this quarter as well?

PN Vasudevan: Yes, actually we have been incurring some costs because some staff have already joined for the liability part of the business. In the quarter ending June, we incurred expense of around Rs.5 crore.

Moderator: We take the next question from the line of Abhishek Murarka from India Infoline. Please go ahead.

Abhishek Murarka: There has been some draft SFB guidelines, which has been circulated to the SFB from RBI. Can you just sort of update us on the basic points in those guidelines and what those guidelines actually try to address?

PN Vasudevan: Well, that's a very individualised letter that's been sent from RBI. It's in a very draft stage. Basically it's trying to convert a lot of the original SFB guideline norms into a more practical user guide kind of stuff. For example where they say – at some point, they say that we'll be broadly subjected to Basel II standardized approach from a Risk perspective. Now they're really trying to say what that means. They said that there'll be grandfathering of bank loans as once you transit into a bank. Now they're saying what grandfathering really means. As you grandfather, then if you have an exposure to other banks beyond two types of exposures, then what happens? So basically the original guideline which was there gave all kinds of general terms. They are now trying to convert it into more user friendly guide or something like that. So that's what they're trying to do and of course we've been given time to get back.

Abhishek Murarka: How does this impact? The working of the bank or increase the amount of work or expense you have to incur for transitioning, anything of that sort?

PN Vasudevan: Not really. This doesn't add any extra burden of compliance or anything like that.

Abhishek Murarka: Sir, the other thing is in terms of your data that you've given. Looking at the average ticket size data, in MFI specifically the QoQ jump has been pretty high. Sir now correlating that with your commentary where you say that a lot of your rollover from first cycle to second then to third are slower because of competition. Ideally the ticket size should not have jumped up so much. So can you just tell us what the contributing factor is over there?

PN Vasudevan: I'll ask Raghavan to take that question.

HKN Raghavan: In the month of August 2015, there was an increase in the ticket size. I think what is important is to look at what was the ticket size before we took an increase. The average ticket size for the first cycle loan was somewhere around Rs.15,000 and the second cycle loan was Rs.18,000, when the industry was operating at Rs.25,000 ticket size. Hence, there has been very minimal increase in our average ticket size which was around Rs.18,555. It is now only at Rs.21,974 whereas the average industry ticket size is much, much higher than this. We have taken a prudent decision because this ticket size revision, which was anyway due, has happened almost after three years. It was not completely in response to the competition also because our tenure is two years as against the competition wherein first cycle loan is around one year. To that extent, what happens is that the revision of ticket size has a large gap.

Abhishek Murarka: Right. This Rs.15,000 is now after the revision or before the revision?

HKN Raghavan: **Rs.**15,000 was before the revision. Post revision, it is now Rs.20,000. So if you look at, it will settle somewhere around Rs.22,000 because the second cycle loan is around Rs.25,000. Predominantly if you look at it, our composition will be 60% for first cycle loan and 30% second cycle loan. So the average was to settle down somewhere around Rs.21,500 from an average Rs.18,000.

Abhishek Murarka: Got it. Sir just lastly a couple of data points. Can you give the number of borrowers in MFI, CV, MSE and HF and can you give the GNPAs at 150 DPD?

HKN Raghavan: MFI clients is 2.8 million and the MSE is 65,000 and vehicle finance will be around 60,000 and the housing finance will be around 3,000 odd.

Abhishek Murarka: And GNPA?

HKN Raghavan: We moved from 1.34% to 1.61% on an overall basis. Now, if we had not moved from 150 to 120 days, but had remained at 150 days itself, then actually our NPA would have been 1.45%.

Vasudevan S: In EFL, VF division, had we not moved to 4 months norms, GNPA would have been @ 3.65%, as against 3.36% as of March 16. While, GNPA of MSE was 0.62% as of March, as of June, it would have been @ 0.76%, he had not moved to the 4 months norms.

Abhishek Murarka: MFI, that's fine.

PN Vasudevan: Stable. MFI, there is no change.

Abhishek Murarka: Right. And HF?

PN Vasudevan: Housing also not changed.

Moderator: We take the next question from the line of Sarvesh Gupta from Trivantage Capital. Please go ahead.

Sarvesh Gupta: Sir, my first question was on PCR. Optically, it looks slightly low. So what's the philosophy around that and do we have a target in mind?

PN Vasudevan: Our NPAs are of fairly young age and that is why the PCR even though – actually we have around 29% PCR today, but as per RBI requirements if you look at it, our requirement is only around 14%. So we do have some extra provisions done there to take it up to 29%. Basically because of our NPA assets age, which is very young and that's why provision at this stage is also low. But as we become a bank, we've also been studying the typical PCR of most of the banks and we find that anywhere between 40% to 60%, seems to be the norm. I mean some of them have around 50% to 60%, many of them have around 40% to 50%. So that's some call we'll take at some point of time after we become a bank, as to what level we will be comfortable with.

Sarvesh Gupta: Understood sir. Sir, one of the slides for EFL, there has been a lot of losses on the sale of repossessed assets. So what are those and why are we incurring losses?

PN Vasudevan: Basically when a customer doesn't repay and we don't see that he is likely to pay by himself, then we end up taking a vehicle back and once we take the vehicle back, we sell it and whatever be the shortfall in recovery, that's booked as a loss upfront while a case with the customer will any way continue separately. If you see slide number 26 in the presentation, Credit Cost, the shortfall loss on sale of repossessed assets was Rs.4.76 crore in the first quarter of previous year. This year, it has slightly come down to Rs.3.83 crore for this quarter, but it's kind of stable around that level. So that's a loss typically when you take it back and you sell it and there is a shortfall in recovery which gets booked as a loss.

Sarvesh Gupta: Sir, what's the LTV here? Should we be tightening our LTV ratios given the losses?

PN Vasudevan: Yeah, 70% to 71% is our average LTV. Our LTV is quite comfortable and these loss ratios are actually very comfortable from a market perspective also. From a credit risk pricing perspective also, it's very comfortable.

Sarvesh Gupta: Sir because most of the vehicle finance companies say that while GNPA numbers can be what they are, but there won't be any credit cost on account of selling of these vehicles because their LTVs are fine. In your case, I mean we're making a lot of losses on the sale of repossessed assets. So are we different from the market?

PN Vasudevan: There were a lot of losses is something that you can debate for long time, a lot of it is basically, something that you have to have two data to compare with, so that you can say which is small of and which is a lot of. But in our case, our overall credit cost as a percentage if you look at it, it's extremely comfortable. In vehicle finance alone, I'll just give you the loss of credit cost in just the vehicle finance division alone, which is one, of course compares very favorably with the industry and second, is that from our own risk return perspective also, it's extremely comfortable. It's kind of built into the product. The credit loss percentage for the vehicle finance alone without including standard asset provision is 2.73%. And overall at the group level if you look at it, our credit cost is around 1.1%. But specifically, your talk on vehicles, the credit cost in vehicles alone, which includes of course the NPA provisioning and loss on sale of asset etc. put together is 2.73% and it is priced in the product. Basically that kind of credit cost is assumed in the product and it is priced in it.

Moderator: We take the next question from the line of Saurav Das from Franklin Templeton, please go ahead.

Saurav Das: Sir, the first question is regarding what you just mentioned and highlighted the risk in the Micro Finance business and as a result of which probably it's reflecting in our disbursement growth as well. But I wanted to understand it from a slightly broader perspective that with this change, is there a possibility of us revising a growth strategy on the other businesses as well? Because I think Micro SME business also has a little bit of sourcing advantage from the MFI. So if the acquisition of the MFI business is going through a little bit of change, are you rethinking on the way you do the other businesses? Some color on the continuous impact on the other businesses would be helpful.

PN Vasudevan: So if you see our views on Micro Finance, it has been kind of steady for a long time now. It is not like we were over the hill sometime back and now we're becoming very cautious or something like that. Right from the beginning, right from 2007 when we started, we have been very cautious on Micro Finance. In fact, December 2007 is the time when we did the first loan in Equitas, first Micro Finance loan and within 2 months from then, that is February 2008, we initiated a meeting of all MFIs in Tamil Nadu to try and see how do we get everyone down together to share database and try to create some kind of a customer data also on who is defaulting and all that. And then within 10 months of starting our operations on 1st of October 2008, we had written a mail to all the MFIs in the country including all the banks seeking their help to come together to try and create some common database, right across the country, of MFIs so that we get to know who is borrowing how much and who is paying and who is not paying. So just to point out that right from the first day, we have been very cautious on Micro Finance because basically it's an unsecured loan. And an unsecured loan, the propensity to over borrow is very high and the impact of over-borrowing can be quite drastic at a client level, forget the company. At the family client level, it can be much more dramatically bad and the responsibility has to be borne by the MFIs, not necessarily by the clients themselves. So we've always been cautious. So it's not like we're never cautious earlier and now we have become suddenly cautious. So the whole diversification program we started 5 years back. All that was part of this concern that we have been having over a period of time. So even now if you see in Micro Finance, while we do continue to grow at a reasonable rate, but we're not overly concerned about losing our position in the market. I mean we have been consistently coming down in the rankings of MFIs based on gross loan outstanding, but that's not ever been an issue for us. We have no problem with dropping down. So whatever we've been doing in Micro Finance, I think we'll continue to do. Our norms are very prudent. Even today if a customer has borrowed, let's say, from one MFI and one bank, I don't lend to them. Though technically I could and my second cycle, third cycle loans and all that are very low. And our loans are always 2 years. It's always been 2 years from the beginning. Even today RBI allows up to Rs.30,000 for a one year loan, which means that you quickly finished Rs.30,000 and give a customer the next cycle of Rs.40,000. Then by the 13th month, your average loan outstanding from the customer is something in the range of around Rs.45,000-50,000, that's the average loan that you'll have on the 13th month. But when I give a Rs.20,000 loan for 2 years, in the 13th month, my average loan will be about Rs.10,000 or Rs.11,000, so the earnings obviously per customer goes down. So we have been very prudent right from the beginning and that process will continue, so we're not really seeing any shift in our strategy in Micro Finance. We will continue exactly where we are. Six months from every customer that we finance on a random basis, we pick up and see how many loans they have taken after they have taken our loan and we still find that around 65% of our customers, we are the only MFI loan provider to them, there are no other loans even after 6 months of our funding them. So we have been actually taking a lot of new customers onboard. Our second and third cycle conversions are low, but still we have been able to put the growth on MFI, principally because we continue to keep acquiring customers, who have not borrowed from anybody else so far. So there is no change in our approach to MFI what we have done in the past is what we'll continue to do, we'll continue to dialogue with the industry to keep on trying to evolve better and better norms to make it more sustainable. And as far as our other products are concerned, I think we're fairly clear in terms of our growth strategy, which will continue.

Saurav Das: Right. In terms of the employee ramp up for the bank if you can just give us an update about the regional manager, the branch manager recruitments etc. are they largely through and in terms of your cost benchmarking with the industry, where would you would benchmark your salaries with the industry?

PN Vasudevan: We have 412 branches for which we received the approvals, so typically in each branch on an average - metros and rural will have different number of people, but if you just mix and match and take an average, you're talking of around 4 people per branch, so that you're talking of around 1,600 staff for the branch banking side. Again on an average basis, there will be some sales staff per branch which will be another about 4 people per branch on an average. You will have less in rural and more in metro whatever, but on an average. You were really talking of 4 branch staff, which is branch manager and branch operations manager and two counter staff for the branch banking and also four sales staff who will go out to mobilize new client relationships for the branch. You're talking of 8 per branch on an average. So if you multiply 8 by 400 it would approximately come to about 3,200 staff. So that should be the total new staff to be recruited. As of now all the senior positions at head office, zonal office, regional office, area office and cluster manager levels, people have already joined and are on their job. At the branch level, we are recruiting in phases because we have these 412 branches will come up in phases over the rest of the financial year. Aligning with the branch opening phase, the branch people will be taken onboard.

Saurav Das: **J**ust the last question on ESOP policy, I want to get a little more clarification on recently issued ESOP plan where there is a total outstanding ESOP options available of 43.3 million shares, which happens to be close to 13% of your total outstanding shares count. If you can give us some sense of a grant rate or how long will it take this pool to get exhausted will give us some sense, as the percentage of outstanding is quite large.

PN Vasudevan: Yes, so this scheme is actually something which was there earlier, so it's a not a new scheme. But because we went for an IPO as per SEBI guidelines, the scheme is required to be put up for an approval to the shareholders at the first shareholders meeting post the IPO, so that is why it was put up for approval once again. Typically, from the beginning, we always tried to hold our options ratio anywhere around 12% to 15% of the outstanding capital, so that's why it is around 13% just now. We believe that this may probably last for about 2 to 3 years, taking into account extra staff will be joining on the liability side also. So anywhere between 2 to 3 years, these options we believe will last. Maybe after that, we may have to come back for some pool at that point in time.

Saurav Das: Is there a stated policy on the exercise price?

PN Vasudevan: Yes, as per the income tax provisions, the price for a listed company has to be the closing price of the previous day. If we don't do it, then the P&L will have an impact for the issuing company. So far we never had an impact on our P&L and Balance Sheet, because our options have been always priced as per the SEBI and IT guidelines. Even the latest grants, we have granted post the shareholder approval went at the closing price of the previous day. Whenever we grant, it has to be the closing price of the previous day.

Moderator: We'll take the next question from the line of Mahesh MB from Kotak Securities. Please go ahead.

Mahesh MB: I just have a few very basic questions. Mr. Raghavan, if you could give a split of your Micro Finance business between urban and rural areas and also what could be the ticket size in Tamil Nadu as we speak today? What is the retention rate that you are seeing in the portfolio at this point of time and what is the kind of rejection rate that you're seeing out there?

HKN Raghavan: Yeah, Mahesh, on the composition of urban and rural - 70% is urban and 30% is rural. And ticket size for Tamil Nadu is no different from other States. We have a uniform ticket size. The first cycle loan is around Rs.20,000 and for bank disbursement, it is Rs.22,000. Second cycle loan is Rs.25,000. Currently, we have the retention rate of 45% only. As far as disbursement is concerned, 60% of our disbursement is first cycle loans and close to 30% is second cycle loans. So that means our third cycle loan and then fourth cycle loan is very, very minimal. We believe there is an influx of new clients as far as the retention is concerned.

Mahesh MB: Sir when you said retention rate is not 45 it's even lower than what you've seen it in the past?

HKN Raghavan: For example, let us say, a client is coming, she has completed one cycle, she is getting into the next cycle. Out of 100, 45 people are only coming back to me. From second cycle to third cycle, it's only 30. So that's the retention rate. As far as the rejection rate is concerned, it varies from State to State. If you look at it, on an average, it'll be somewhere around 15% to 16%.

Mahesh MB: It's okay. That's not much as of now.

HKN Raghavan: See as far as this one, credit bureau check is happening, today we have the facility where the sales officers on the go can actually do a credit bureau check, which is also creating a lot of rejection and second is clients are becoming more aware that you know it is not some where machine who is sitting centrally rejecting. We find that a couple of clients who would try and then somehow manage, actually kind of get up and get away from the center meeting that they know that records will be caught.

Mahesh MB: Perfect. The employee size at the Micro Finance today?

HKN Raghavan: It'll be 5,600.

Mahesh MB: My last question is on the SME piece. In terms of origination, does the Micro Finance team help completely or is there a separate arm which does this?

HKN Raghavan: SME is actually completely cross-sell to the Micro Finance clients, so the Micro Finance team actually cross-sells to the Micro Finance clients. Basically over the period of time, when we have done surveys, we found that somewhere around 10% to 15% of our Micro Finance clients base are capable of going to the next level. For such clients, you know the proper due diligence is done by the credit team after identification by the Micro Finance team. And then based on the due diligence and the credit assessment, the ticket size is fixed and then disbursed. Currently, 70% of the clients are the Micro Finance clients out of what we disburse and 30% are general. Even this 30%, though they are not clients to Equitas Micro Finance, but the profile is the same. Micro Finance client would refer her relative, her friends, basically the profile is the same, but the clients of Micro Finance, who belong to Equitas is 70%.

Mahesh MB: My question was a little bit different in the sense that once the loan has been originated by the Micro Finance team, who manages the relationship after the account has been opened?

HKN Raghavan: Yeah, once the account is opened and all the relationship is maintained by the Micro Finance team itself.

Mahesh MB: So the MFI team still leads the relationship.

HKN Raghavan: Yes, credit is the one which is separate. Independently, credit department is there which will do the credit assessment of the client while the final relationship is done by the Micro Finance team itself.

Moderator: We take the next question from the line of Vivek G from GS Investment. Please go ahead.

Vivek G: Yes, I just wanted to say that a lot of growth is creating a lot of attraction for Micro Finance sector, so is there a fear of bubble and what are being the reasons to negate that in terms of RBI supervision and credit bureaus and other things which are helping it out?

HKN Raghavan: Yes, as you're aware that as per RBI guidelines, it is not more than two MFIs can lend to a client and this is suitably and well-supported by the credit bureau, which actually churns out the data, the moment you enquire, it actually throws out the data about how much client is leveraged. As far as the credit limit is concerned, RBI has talked about Rs.1 lakh credit limit. Internally, MFIN voluntarily we have capped it at Rs.60,000, which I think is a very prudent measure. Now the scenario is that when the eight Micro Finance companies become an SFB and some of the private banks have also started lending to the clients, they do not fall under the definition of two MFIs. That means potentially you will have more than two MFIs plus another two / three banks can lend, so they're not covered by the guidelines. So this is where we expect there could be some over-leverage as far as client is concerned. It is an unsecured loan and client will be always tempted to take more loans when it comes without any condition. While we don't see any kind of bubbles across sectors, but there could be some hotspots where clients can slip through the credit bureau and get over-leveraged. This has been identified as an issue and then at the sectoral level, we're talking to all the stakeholders and arrive at some kind of a norm which can actually ease this kind of over-leveraged issue in the industry.

Vivek G: Basically, there was an article that Mr. Nilekani is propagating along with Credit Suisse that JAM Trinity - Jan Dhan, Aadhaar and Mobile are going to create lots of positivity for the retail finance sector in the next 10 years. Is it going to be beneficial for Micro Finance also? If yes, how can it be and how will Aadhaar and other things like Dhan Yojna, Mudra Yojna helping out everything else?

HKN Raghavan: I think this is a very important development as far as the financial inclusion aspect is concerned. I think the JAM Trinity will actually help your banking on your palm through your mobile, so what happens is that a client can today save, transfer through a mobile phone and payments can also happen through JAM Trinity. I think overall this will help to a great extent in terms of financial inclusion and also kind of reducing the cash transactions. A lot of electronic money can actually get transferred. So I think this is definitely an impact, not only for Micro Finance, but everybody else in general.

Vivek G: What about the impact of DBT, Direct Benefit Transfer?

HKN Raghavan: I think today as the government claims the direct benefit transfer is happening directly into the account to the Aadhaar-based accounts and we are also seeing for the government which claims about Rs.32,000 crore of amount is lying there in the Aadhaar accounts, that it's quite possible that can influence in terms of spends.

Vivek G: Good for us.

PN Vasudevan: Actually, you know what happens is that today Aadhaar seeding has happened in many accounts. Now some of these customers are finding it very easy and convenient to transact small values frequently with this bank. They will definitely be happy to continue on this bank. But if they have any issues regarding dealing on a continuous business for small value and if SFBs like us are able to provide them through both the online and offline assisted means and through a branch channel, through a BC channel if we're able to provide them a truly meaningful and real access for putting in and taking out small value transactions without too much of hassle or cost, then they may be principally willing to move their Aadhar account or the DBT account to us and Aadhaar really makes that process of moving the DBT to us instantaneous. It's just a flick of a button without any effort that DBT can move into us and I think that is what really can be a great game changer for SFBs like us. If we're able to crack this ability to give access to their accounts on a frequent basis for small values without too much of cost or hassle, then we could potentially be able to get them to move their DBT account to us and moving those account becomes absolutely easy because of Aadhaar.

Vivek G: Overall opportunity size remains good and healthy for us?

PN Vasudevan: Absolutely.

Moderator: We'll take the next question from the line of Roshan Chutke from ICICI Prudential Asset Management. Please go ahead.

Roshan Chutke: I just have a couple of questions. In the MF business, what percentage of our growth in disbursement is because of new customer addition?

HKN Raghavan: Every month it's close to 60% of the new clients which we are acquiring, that will be close to almost 40% of all our disbursement with the new clients. The growth will be contributed by that. 40% of the growth will come from the new clients' acquisition.

Roshan Chutke: Sir, out of this, 29% growth that we have seen year-on-year, you're saying approximately 12% have come because of new customer acquisition. I was just doing some math. Sir, you said out of these 2.8 million customers that you have, 60% fall in the first cycle, 40% or so fall in the second and third cycle right? If I take 60% of this 2.8 million, it works out about 1.68 million. Now out of this 1.68 million, you're saying only 45% go through the second cycle?

HKN Raghavan: Yes, 30% goes to the second cycle.

PN Vasudevan: 35% goes to second cycle.

Roshan Chutke: From the second cycle, you said 30% go to the third.

PN Vasudevan: Yes, correct it's 45%.

Roshan Chutke: 45% go to the second cycle. It means 55% is dropout. 55% of this 1.68 million is about 0.924 million. So they're the ones which are getting out of the system. Again if I do the same thing for the second cycle to third cycle dropout, second cycle is about 1.12 million.

PN Vasudevan: Another 30% conversion there.

Roshan Chutke: Yes, 30% conversion from the third cycle and beyond, right, approximately.

HKN Raghavan: Yes.

Roshan Chutke: So the dropout from that is about 0.784, so 0.784 plus 0.924 is about 1.7 million. I remember the number last year was about 2.7, 2.8 million customers that we had, so actually…

HKN Raghavan: We had 2.5 million. Yeah.

Roshan Chutke: Even if we take 2.8, if the number is the same, we're talking of roughly 1.7 million fresh customers having been added in this 1 year period apart from the 0.3 million that you mentioned.

PN Vasudevan: Yeah, that is because 60% of our disbursement is to first cycle loans, so yes, you're right, 60% of 2.6 or 2.7 million is approximately 1.7 or 1.8 million.

Roshan Chutke: So that is a kind of new customer that you're adding, is it?

PN Vasudevan: That's right. Yes, Actually in our system what we have done, again right from the beginning is that our process of sourcing and our process of KYC verification, our process of group bonding verification - everything we actually have made it exactly the same whether the customer is coming for the first time or the fourth time, there is no difference. We are not really going for a shortcut or we are not going for a shorter process for approving the loan for the third or fourth cycle customer compared to the first cycle customer. So actually from a cost perspective, we are immune whether the customer is of first or the fourth cycle and that is why we have really not had the pressure on us to try and improve this percentage of conversion. At any point in time, we are quite comfortable, I mean ultimately only 45% want to come back and deal with you. We are comfortable at that level of percentage and let others pass by, may be because they have borrowed from too many people in the intervening period and we're comfortable giving loans to that 45% again. We don't have a pressure on us to try and improve the ratio because our cost is the same whether it's a first or the third or the second cycle customer.

Roshan Chutke: Sure, but is it not acquiring new customers very difficult?

PN Vasudevan: Well, actually that is where the double side of Micro Finance comes out really. On one hand, you know we are always worried about the glut and the over-leveraging and all the potential hassle of not borrowing too much and on the other hand, you have a huge sea of people who are not having access. That's two sides of Micro Finance. Both of them actually are true and they exist side by side. That's the reality. It might appear that it should be difficult to acquire new customer. But in reality as you said sometime earlier, 65% of all our customers were only financiers to them. They don't even have a second MFI loan. So both of them exist side by side. Extremely high leveraging and also total lack of access, both of them actually are existing side by side.

Roshan Chutke: And the other question is on saturation in industry in the 3 years hence. In fact you mentioned Equitas estimates that industry can do it 30% to 35% for the next 3 years. So beyond 3 years, do you think the industry will start getting saturated and therefore what are your plans to get immune from that?

PN Vasudevan: See one is that the growth will continue if not at 40%, 50% of current levels, maybe it'll tone down to 25% or 30% at some point in time. At some point, we may witness sustainable growth rate than the current rates. Second thing is in terms of growth, the newer borrowers, newer geographies, they will continue to keep contributing. Third is at certain level of inflation adjusted increase in the loan size will also be a factor of contributing in terms of the disbursements. I think may be over time we may see that 20%, 25% becomes a sustainable growth rate in the industry.

Roshan Chutke: 20%, 25% based on, okay, inflation of about 10%.

PN Vasudevan: Yeah, 10% maybe adjusted for just inflation perspective and at 10% of new clients coming into the system on a yearly basis.

Roshan Chutke: The industry size is 3 lakh crore.

PN Vasudevan: 3 lakh crore is going to take some time to reach. I don't think it's going to be reached in may be just 3 years' time. It'll take some time to reach.

Moderator: We'll take the next question from the line of Rahul Ranade from Goldman Sachs Asset Management. Please go ahead.

Rahul Ranade: I would just like to know the degree of overlap between our borrowers on one hand and the beneficiaries of the social initiatives that we take on the other.

PN Vasudevan: See our health program, we have now benefitted over 40 lakh people and that's a complete overlap with our existing customer base because we keep informing in our center meetings about all health camps and the clients and their family members come for this health camp. Similarly, we have done the skill training. We have trained over 400,000 people so far. That's again only for the client base and their family members. So these two programs clearly are only client facing. As far as our schools are concerned, we have 5,000 children in the schools, of which, about 25%-26% children are of our MFI customers. As far as job fairs are concerned, 65,000 people were placed on job so far, but that may not be necessary only our clients because we just announce that in the local community, anybody who is unemployed may come in, so that may not necessarily the only from our clients' family members. But mainly first two major programs which is our health and skill training is almost exclusively for the client base.

Moderator: We'll take the next question from the line of Anand Vasudevan from Franklin Templeton. Please go ahead.

Anand Vasudevan: I see that there has been a spike in NPAs in the housing finance business. If you could take us through the reasons for that and what sort of – you said you're also looking at some efforts to regularize these accounts.

Management: Yes, so housing finance we are just offering it from 16 branches right now. It's not a very scaled up business and constitutes 4% of the book, it is about Rs.250 crore in terms of loan book. Earlier when we had started we had a product which is going from Rs.5 lakh to Rs.1 crore. But about a year and half back or may be 15 months back, we took a decision to curb the upper end of the loan. So the loans were pruned to Rs.5 - 40 lakhs in Chennai & Mumbai and Rs.5 - 30 lakhs in all other cities. So basically the NPA that has shot up from 2.5% to 3.9% in the quarter is largely contributed about handful of accounts, 4-5 accounts, which is all in the range of Rs.50, 60 lakhs to 70 - 80 lakhs funding, which we are working on and because we have SARFAESI also in the housing finance company whenever required, we're also using that SARFAESI process to try and regularize these accounts. Just a few large and larger transactions which have spilled over into the NPA segment we are dealing with that. But going forward in terms of our plan on housing as we've mentioned earlier, affordable housing Rs.5 to 25 lakhs or Rs.5 to 30 lakhs is going to be a big opportunity and with 400 branch network that we're setting up in place, the branches itself will be a big sourcing option for home loans. Actually, we don't have a business head and this has always been run as adjunct to some other business so far, but we're now looking at taking people to separately head it and run it as a proper business vertical and using the 400 branch networks as a sourcing area, so that's what we wanted to do going forward. This is where we are currently.

Moderator: That was the last question. We now hand the conference over to Mr. PN Vasudevan for his closing comment.

PN Vasudevan: Thank you. Thank you so much for being with us on the call. Thank you for all your queries. I hope we have been able to address them reasonably well. We are always open to any suggestions, ideas from any of you in terms of what further you think we can do in our presentations, in our disclosures, we will be very happy to take any feedback and give further disclosures wherever it will help you in terms of understanding of the Company. We thank you very much once again for being with us and see you next quarter. Bye-bye.

Moderator: Thank you. We conclude this conference call. Thank you for joining us and you may now disconnect your lines.