"Equitas Holdings Limited Q3 FY '19 Earnings Conference Call"

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MANAGEMENT: **MR. S. BHASKAR – EXECUTIVE DIRECTOR & CEO - EHL**
MR. P. N. VASUDEVAN – MD & CEO - ESFB
MR. SRIDHARAN N. – CFO - ESFB
MS. SRIMATHY RAGHUNATHAN – CFO - EHL
MR. H. K. N. RAGHAVAN – SENIOR PRESIDENT, INCLUSIVE BANKING & VEHICLE FINANCE - EHL
MR. SANJEEV SRIVASTAVA – PRESIDENT & COUNTRY HEAD, BRANCH BANKING, LIABILITIES, PRODUCT AND WEALTH - ESFB
MR. BHADRESH PATHAK – PRESIDENT SME BANKING - ESFB
MR. RAM SUBRAMANIAN – HEAD CORPORATE BANKING - ESFB
MR. ALOK GUPTA – CHIEF RISK OFFICER - ESFB
MR. NATARAJAN M – EVP TREASURY - ESFB
MR. DHEERAJ M – HEAD STRATEGY AND IR - ESFB

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Equitas Holdings Limited Q3 FY '19 Earnings Conference Call. We have with us today, Mr. S. Bhaskar, Executive Director and CEO, Equitas Holdings Limited; Mr. P. N. Vasudevan, MD & CEO, Equitas Small Finance Bank Limited; Mr. Sridharan N. CFO, Equitas Small Finance Bank; Ms. Srimathy Raghunathan, CFO, Equitas Holdings Limited; Mr. H. K. N. Raghavan, Senior President, Inclusive Banking and Vehicle Finance; Mr. Sanjeev Srivastava, President & Country Head, Branch Banking, Liabilities, Product and Wealth, Equitas Holdings Limited; Mr. Bhadresh Pathak, President SME Banking, Equitas Holdings Limited; Mr. Ram Subramanian, Head Corporate Banking, Equitas Holdings Limited; Mr. Alok Gupta, Chief Risk Officer, Equitas Holdings Limited; Mr. Natarajan M., EVP Treasury, Equitas Holdings Limited; Equitas Holdings Limited; and Mr. Dheeraj M, Head Strategy and IR, Equitas Holdings Limited.

As a reminder, all the participant lines will be in 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. I now hand the conference over to Mr. S. Bhaskar, Executive Director and CEO, Equitas Holding Limited. Thank you and over to you, Sir.

S. Bhaskar: Thank you. Good Afternoon everyone. Welcome to the Equitas Holdings Limited Q3 FY '19 earnings call. Our company had a reasonably good quarter, total advance as of December 2018 stood at Rs. 10,861 crores registering a growth of 41% on a YoY basis, with a stable portfolio yield at 19.3%. Consolidated profit after tax for the quarter was at Rs. 62.5 crores as against loss of Rs. 30 crores in the corresponding period last year. Return ratio for Q3 FY '19 also saw an improvement with ROA at 1.71% and ROE at 10.43%. We continue to witness good traction in all the divisions of our banking business and before I invite P. N. Vasudevan to take you through the performance of the bank in detail, I would like to update you on the listing of the bank in accordance with the licensing requirements of RBI.

The Board of Directors in its meeting held on February 1st 2019 has approved a composite scheme of arrangement to be entered between the company the Equitas Small Finance Bank Limited and their respective shareholder subject to various regulatory and other approvals. The scheme envisages the issuance and allotment by ESFBL of 89.21 crores equity shares for no cash consideration to the shareholders of EHL as on the record date in proportion to their shareholding in EHL on that date. This is by utilizing the share premium and reserves available as of March 2018. This would help to list the bank shares as well as to bring the company's holding in the bank down to 53% from the current 100%. We would have another 2.5 years till September 2021 to bring it further down to the RBI requirement of 40%. I now hand over the call to P. N. Vasudevan to take you through the details of the bank.

P. N. Vasudevan: Good Afternoon to all of you and thank you for dialing in to our call, thank you, Bhaskar. We had a good third quarter backed by robust growth in advance, stable operating expense, and continued traction in the new products. Our microfinance portfolio was marginally impacted by the cyclone, Gaja, that hit South Tamil Nadu on November 16, 2018. We have 10 branches in the four affected district and the total par value as on January 2019 stands at Rs. 59.98 crores, which is down from a peak of Rs. 73 crores; however, the par from customers who have not paid any installments from November is about Rs. 12 crores and the collection efficiency has improved from about 40% in the month of November 2018 to about 71% in January 2019. Based on our past experience of similar natural calamities earlier, we believe there will be no loss arising from this and overtime they would get paid. You can find a detailed breakup in the presentation. In Q3, our overall disbursement touched Rs. 2,265 crores registering a growth of 43% YoY. Strong growth was seen in small business loans, which are secured in nature with a growth of 63% while vehicle finance saw a growth of 26%, and microfinance a growth of 20%, however, disbursements in corporate loans was muted as we have slowed down our lending to NBFCs.

Also, we continue to scale down our unsecured business loans where the overall market feedback on the delinquencies from the sector are not very comfortable. Our NIMs have improved from 7.77% to about 8.98% sequentially. This was aided by a 50 basis points increase in the yield on advance and scaling down our surplus investment book, however, this may come down as a mix of portfolio changes over time, but it will also then be supported by a lower operating cost which will be the cost arising from the revised portfolio mix. The banks GNPA remained reduced to 3.13% in Quarter-3 against 3.36% in Quarter-2 as we continue to see improvements in collections and recoveries. A stable asset quality is of paramount importance to us in order to grow the book. On the liabilities front, we increased the FD rates in November, which helped support the growth of FDs. We mobilized around Rs. 900 crores in FD for the quarter compared to just about Rs. 75 crores in the previous quarter. Given the last two quarters trend where at the sector level, the growth of deposit has been less than half the growth in advances, we believe the coming year is going to be a year where banks would be distinguished based on their ability to mobilize deposits. We have moved early on this and focused our resources on deposit mobilization and the traction we have seen over the last three months has been pretty good.

The bank’s CASA remained relatively flat as some large deposit exited and some retail savings balance got converted to retail FD. Our focus on CASA would continue to remain on the granular CASA balance and we will not be competitive on the bulk accounts. We have continued to progress well on third party distribution and the bank has mobilized over Rs. 115 crores in insurance premium, and in mutual funds, the asset under management has crossed Rs. 90 crores. On the Treasury front, out of Rs. 325 crores of CPs and NCDs, CPs worth Rs. 200 crores and NCDs of Rs. 25 crores have been redeemed as of date. We have also received a refinance sanction from SIDBI for Rs. 600 crores during the quarter.

To sum up, we are seeing strong growth in all our lending products and our book continues to diversify well. The portfolio quality continues to remain healthy and stable and businesses are able to improve the sales productivity and operational efficiencies. We believe that we are on the track to achieve the growth target set out for the year. With this, I would like to hand over to the operator and we will be happy to take questions from your end. Thank you.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, we will now begin the question and answer session. We have our first question from the line of Kunal Shah from Edelweiss. Please go ahead.

Kunal Shah: With respect to this entire arrangement scheme, if you can further detail out in terms of the roadmap as to, so listing is something which is required by September 2019, so will it be prior to that and maybe in terms of the timelines for the various approvals which are needed and when you look at it in terms of the bank shares, so the existing shareholders of Equitas Holdings, how many is the bank shares which each shareholder would be getting?

P. N. Vasudevan: Under the scheme, as we mentioned earlier, the bank would be issuing new shares directly to the shareholders of the holding company by capitalizing its own free reserves and share premium as of March 31, 2018. The amount of premium that we had as of March '18 when we convert that and capitalize that, that actually works out to 47% dilution and that is where 47% is arrived from. In terms of timelines and activities, this would require approval from RBI, SEBI, and both the stock exchanges after which we will have to file it with the NCLT, Chennai, and NCLT would then convene shareholders meeting. It would need to be approved by the shareholders and then go back to the NCLT for final approval and post NCLT approval, we would have to again apply to the SEBI through the stock exchanges under the SERA Act and we would need to get SEBI's permission to lift the shares of the bank without doing an IPO, so these are the processes and these are the various approvals required. All of them will take some amount of time, but we are confident that by our timeline of September 4, 2019, we should be able to lift the bank shares. In terms of the number of shares that a shareholder of the holding company will get, that would be based on the swap ratio. The swap ratio will actually be calculated as on the record date to be fixed once the NCLT approval has come. Just from an indicative perspective based on current data, the swap ratio will be something like 2.6 which is that for every one share of the HOLDCO, a shareholder should get 2.6 shares of the bank, but this is subject to change. The scheme only talks out the methodology for arriving at the swap ratio and that will then be calculated based on the numbers which are there at that point in time, but roughly it may be in that range.

Kunal Shah: One shareholder will get 2.6 based on the current data?

P. N. Vasudevan: Yes, but do not hard-core that because the scheme itself does not talk of this 2.6. The scheme only lays down the methodology of calculating the swap ratio, so we will actually do the calculation of swap ratio sometime when the record date is announced.

Kunal Shah: When we look at the reduction in the securities premium, so what is that amount actually?

Sridharan N: Securities premium and reserves and surplus in the P&L account as on March '18, which is eligible under the Companies Act is Rs. 892 crores.

Kunal Shah: And this we will be bringing it down entirely to zero in terms of the issuance when we are making the scheme?

Sridharan N: There will be something which will be left out, because certain statutory reserves and other things we cannot touch it, that will be there.

Kunal Shah: But significant part of this will get utilized?

Sridharan N: Exactly, as of March 31, 2018, that will be addition when we do that during the year, that will get added separately to the P&L.

Kunal Shah: Post this entire arrangement, will both the entities be continued to be listed?

P. N. Vasudevan: Yes, both of them will continue to be listed till the time that we are able to get an approval to merge the two entities, both will continue to remain listed.

Kunal Shah: Then maybe in terms of bringing it down further to 40%, there will be another scheme of arrangement which will be worked upon because there still it is like 2.5 years' timeframe which is still there?

P. N. Vasudevan: True, absolutely.

Kunal Shah: Secondly, in terms of the overall growth, we had seen a very strong momentum out there, but on the deposit side when you look at it, I think particularly the traction has on the retail as compared to that of CASA, so anything to read into and how should we look at it going forward in terms of the deposit scale up?

Management: Basically, we had carefully looked our interest rate prevailing in the market and we had increase the retail TD rate from November 1st, so lot of traction happened on retail TD. We are happy to see a good growth impact. Q3, we overall did a growth of 900 crores on our total deposit side, so lot of customers who were keeping money in savings account, they also moved in that process, so we could see a mobilization of 120 crores which moved from low savings account less than 10 lakhs and moves into the retail TD, so that is the reason we have seen a higher traction and a bit slowness on savings account, but we have also built in close to about 220 odd crores savings account, but majorly due to the reason lot of customers moving to FD and also we have seen some outflows from our 10 crore plus bucket, so that has resulted a bit of muted savings growth, but overall the total deposit has grown by Rs. 900 crores in the last quarter.

Kunal Shah: In terms of rate which we are offering on TD?

Management: Our rate for one year is 8.5% and for two years we are offering 8.8% to normal citizens.

Moderator: Thank you. We have the next question from the line of Amit Nanavati from Nomura Securities. Please go ahead.

Amit Nanavati: Sir, my question is on PSLC expense, we had a 24 crore hit in this quarter, so over full year we booked PSLC income or we would have booked 28 crores of PSLC income versus 24 crores of PSLC expense that we have booked, just wanted to understand what part of your book is PSL compliant and why such a larger cost even at 1% would imply a 2,300 – 2,400 crores of portfolio purchase, so what should be the normalized run rate one should assume into next year?

P. N. Vasudevan: Normally speaking, our book should be sufficiently compliant for our 75% PSL requirements, but in the previous year, we had sold some PSLC which we believed was more than what we were required, but there was a time when we started, when we did not have a target for PSLC the initial stage and we believed that because we did not have a target, we could sell some of our book under the PSLC and we did that, but RBI came back with a clarification that when we do not have a target then we are not supposed to have any excess PSLC, so we cannot be really selling PSLC at that point in time. They asked us to add it back to our ANBC calculation and recalculate the PSLC requirement for the current year, so when we did that then we had to buy some PSLC from the market to make up for what we had sold earlier and that is why we had to buy it, it was a one-time that we had to do that.

Amit Nanavati: Sir, is it fair to expect that getting into next year you will not have any PSLC income neither you will have any PSLC expense, on a net-net basis you would be about 75% compliant?

P. N. Vasudevan: Yes, net-net I do not think we should be either selling or buying broadly speaking.

Amit Nanavati: Secondly on your margins, so there are few moving parts here you had some asset optimization with your investment book running of plus when you look at your funding cost as well while TDs have gone up your legacy book in terms of higher cost borrowings has been coming down and getting into next year, your legacy book in terms of higher borrowing cost has already run off. When you look at incremental growth, the lower yielding corporate book, MSE book has not grown sequentially which should start growing into next year, so all the benefits basically from a cost of fund side may have got squeezed out and yields will start coming down which should get netted off by OPEX optimization, is that a fair expectation to build in or?

Management: Absolutely, you are right.

Amit Nanavati: Anything on the SA side, I see SA cost has increased by 7 to 8 basis points despite we shedding of bulk SA looks like, your ticket size has come down but daily average SA cost is up 7 to 8 basis point?

Management: We have also increased marginally the interest rate on savings account, could be a function of that, but we have also brought down the interest rate on below one lakh from 6% to 5.5%.

Moderator: Thank you. We have the next question from the line of Jehan Bhadha from Nirmal Bang Securities. Please go ahead.

Jehan Bhadha: Sir, my first question is a follow from the previous question on scheme of arrangement, so are we saying that this 53% holding company which will continue to hold in the SFB these are tentative thing and this can be revised actually lower and instead of this 47% dilution, the dilution could be higher based as on the date of the NCLT approvals etc., so there is a possibility that higher number of shares can be given to the holding company shareholders?

P. N. Vasudevan: No, the scheme takes the reserves as of March 31, 2018, only, so this percentage is frozen, the percentage will not change.

Jehan Bhadha: Sir, second question is you explained that on the corporate side there was slight slowdown, but also I observe that your home loans as well as MSE loans have come down quarter-on-quarter, so any particular reason and how should we look at growth specifically on the MSE and home loans?

Bhadresh: MSE in Quarter-2 was 522 crores, so MSE has two components to it. One is the unsecured business loans, which we are consciously de-growing, since in our opinion it would be a little risky segment to deal with, so we are de-growing the unsecured business loans book but we are growing the working capital and secured term loans book, so as a result the growth from Q2 to Q3 appears to be a little flattish. We have grown on the working capital side and secured term loan side, and it is a constant strategy that we follow.

Jehan Bhadha: What would be the split between secured and unsecured book in MSE?

Bhadresh: Right now, as of December the total advances of 521 crores comprise of 102 crores of secured advances because secured advances we just started a few months ago. We were having an unsecured business loan’s book which started in 2017, later half of 2017, so that is our legacy portfolio which we are running down consciously for controlling the risk whereas secured, we are growing steadily quarter on quarter.

Jehan Bhadha: On the home loans side, that has also come down?

HKN Raghavan: On the home loan side actually if you look at it the home loans prior to that if you look at the previous quarter, we had clubbed home loan along with the LAP also, so the thing is that if you look at the another slide which is Slide Number 21, you will exactly find home loan is given separately, so there is a 39% growth year-on-year there and we have now started giving in that, so that I think should be able to give you clarity on that.

Jehan Bhadha: I was actually referring to quarter on quarter

HKN Raghavan: I have given the split in Slide Number 21.

Jehan Bhadha: Last question is on NIMs, now we were actually expecting what happened in this quarter the investment book coming down, but is there more scope for this to continue going into next quarter, can the NIMs further increase because still our investment book is actually much more than requirement?

Natarajan: The scope for further reducing the investment book is sort of limited in the sense we do have surplus SLR, but that is more to do for liquidity management. We typically want to have at least 15 days of forward liquidity in addition to giving some cushion for LCR and as business grows, we will also be requiring as NDT will also go up and we will need some more securities, so I do not see any significant reduction in the surplus portion of SLR because we are almost now at the optimum level of surplus investments. We do have some Rs. 100 crores of NCDs, that should mature, so we will be looking out to completely dry the non-SLR book.

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

Deepak Poddar: Sir, we have been talking about OPEX around 250 crores a quarter is what we are looking at. Currently, we are at about 263 crores, so is this the peak that we should look at in terms of our absolute cost or some understanding on quarter-on-quarter sequential growth in cost that we might be looking at?

P. N. Vasudevan: Our operating cost of Rs. 263 crores consist of this one-time expenditure of 23.8 crores of the PSLC premium paid, this is a one-time. The total cost that we paid for that was 29.5, so we have booked a pro rata amount in the third quarter, which is three-fourth of the amount and one-fourth which is the remaining approximately about 6 crores or so would get booked in the next quarter. This was a one-time event, it is a non-recurring event, but minus that if you see our operating cost should be in the range of Rs. 263 crores minus Rs. 23 crores is around Rs. 240 crores. Our expenses remained kind of flat over the last few quarters at around Rs. 240 crores, Rs. 232 to Rs. 240 crores and it might remain flat for maybe a quarter or so more, but slowly we should start seeing that increasing because we are investing in the sales team for some of the new products. We are expanding our sales team and the plan is that for the next year, we are not really looking to enhance branch network substantially. We will probably do may be about 5% to 7% branch expansion, but that will be closer to the second half of the next year, but in the beginning of the next year, we will be investing in our sales team in our existing branch networks to help get the market where we are currently present in lot more deeper manner, so that sales team should add to our cost, but that will be the one that you should be seeing over the next one to two quarters, and our branch expansion adding to the cost, you should be starting to see some time by the second half of next year, but again as I said earlier the potential to improve productivity still remains quite high and leveraging and also cross selling to our existing customer continues to present a very good opportunity, so even though we will probably look at a significant growth for next year also, but our branch expansion will be very much lesser than the percentage of growth that we should look for at the business level.

Deepak Poddar: Basically, you mentioned branch expansion will happen only in the second half of FY '20, so next two to three quarters, our OPEX will remain flat and then we might see some increase in our OPEX cost, so overall on the annual basis, a similar kind of increase in OPEX is that what is a fair assumption like maybe 10%?

P. N. Vasudevan: Yes, I think that is a fair assumption.

Deepak Poddar: Sir, my second question is on other income, so in other income what is the trend we are looking at in terms of other income?

Sridharan N: If you look at the Slide Number 46, the total other income around Rs. 65.41 crores, so if you remove the PSLC income which may not repeat, so it will go up according to the growth in the advances actually.

Deepak Poddar: After adjusting for this, I missed the number what is the PSLC income in this quarter?

Sridharan N: Rs. 7.04 crores is accounted for the quarter.

Deepak Poddar: If I remove that Rs. 58 crores is what would be the adjusted number?

Sridharan N: Correct, and the asset fee income will move now up according to whatever the increase in the portfolio, the disbursement and liability fee income also will go up.

Deepak Poddar: Sir, if I have to assume let us say 30% to 35% growth in our loan book AUM, a similar trend is what other income can also be visible, right?

Sridharan N: If you look at the advances, each line of advances has a different component of processing fee vary from 0.5% to 1.5%, so according to the mix it will move up.

Moderator: Thank you. We have the next question from the line of Nishant Shah from Macquarie Group. Please go ahead.

Nishant Shah: Sir, first question on the scheme of arrangement, what would be the tax and stamp duty and any other like incident expenses on this arrangement, would it be a meaningful number or it is negligible?

P. N. Vasudevan: We have gone through the tax provisions and taken advice from our tax consultants and tax lawyers and the opinion from the tax lawyers is that the scheme that we have currently put out should be that neutral for the bank as well as for the shareholders.

Nishant Shah: Nothing on stamp duty either?

P. N. Vasudevan: That is not significant.

Nishant Shah: Second question, we have been hearing that the RBI is forming a committee to have a relook at all the HOLDCO structures and whether like the collapsing of the HOLDCO can be done, so in this light is this scheme of arrangements like definitely going to happen or in case the RBI does come out with some formal guidelines about that, then this would be abandoned and you would be more open to collapse the HOLDCO structure into the FSB?

P. N. Vasudevan: Our first choice was always to collapse the HOLDCO structure with the SFB, that was always our first choice and as you know we did apply to RBI, but they turned that down about couple or three months back, but anytime that RBI is in a position to approve our request for a merger of the two always our first preference is that without doubt.

Moderator: Thank you. We have the next question from the line of M. B. Mahesh from Kotak Securities. Please go ahead.

M. B. Mahesh: Sir, in continuation of the previous question, just trying to understand again from a standpoint where the shares are issued to the parent shareholders of the subsidiary, how is the exact definition of the scheme of arrangement, is it a dividend, is it a bonus, how should one look at the, is it a spin-off, how do you look at this entire format? Second, correspondingly you said it is a tax neutral event, just trying to understand on how do you interpret this as a tax neutral arrangement?

P. N. Vasudevan: In terms of the scheme, it is not a rights or a bonus issue because if it is a rights or a bonus issue, it will go under a different section of the Companies Act, Section 62 or 63. This is a scheme of arrangements under Section 231 of the Companies Act, so this is a scheme of arrangement between the companies involved and the shareholders involved and under the scheme, the shareholders get together and agree on a certain arrangement between themselves and as part of that arrangement, shares of the bank get issued to the shareholders of the holding company, and that is why this has to go through the NCLT process and then whatever I had mentioned earlier in terms of the various approvals in addition to the NCLT process etc., so this is actually neither rights or bonus, it is not Section 62 or 63 issue at all. It is an arrangement under 231. In terms of the tax part of it, anyway when we come out with the information memorandum at a later point in time, we would be giving the highlights of the tax consultants' opinion as part of that IM where lot more details would be mentioned, but the summary of that advice to us is that there will be no tax liability either on the bank or on the shareholders.

M. B. Mahesh: Just one thing here, has there been any specific instance in the past that you have seen a scheme of arrangements being done so far across the entire market?

P. N. Vasudevan: There are lot of examples of schemes of arrangements of different types, so this is a different kind of scheme that we are looking at, but in the past there have been instances of such kind of schemes being approved and where the shares are issued to someone which is neither under 62 rights nor under 63 bonus, but issued to someone else so there have been lot of schemes and there have been such instances, but if you ask me is there anything which is exactly like ours, I would not know, but there are different type of schemes, so it is just part of that arrangement under 231.

M. B. Mahesh: Just one clarification on this again, from a shareholder standpoint I would be treated as a capital gains and capital loss in this transaction similar to what happened in IDFC, is that the taxation angle onto it?

S. Bhaskar: No, I think it will not come under capital gains because the view is that there is not a transfer involved.

M. B. Mahesh: But I would have capital loss, when the subsidiary is listed at the parent, when I am holding the shares of the parent?

S. Bhaskar: Yes, if the share price of the holding company falls and if it is booked then the loss will be there, capital loss, but otherwise it is notional loss when the shares are issued by the bank.

M. B. Mahesh: When can we get clarity on the scheme of arrangement?

P. N. Vasudevan: The scheme would be put up to SEBI for approval shortly and when that is done, I think it will also be put up in the website, so we are hoping to do it within a week or so we are hoping to really put it out and as soon as we apply to SEBI, I think as per that process I think it goes on to the website also, so probably a week from now.

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

Nidhesh Jain: Sir, first on the asset quality, we have seen slight deterioration in MSE book, are there any red flag or instances in any other segment which may lead to asset quality deterioration going forward?

Bhadresh: The asset quality deterioration which appears in the MSE book is on account of the shrinking portfolio of unsecured business loans and it is a conscious call that we are taking, so on one hand, we are growing the secured portfolio of working capital and secured term loans and shrinking the portfolio of unsecured business, so with going time it is only the value that will matter rather than the percentage.

Nidhesh Jain: In terms of value, do you think this has peaked out and it will not increase going forward in MSE book or?

Bhadresh: I think there could be further deterioration happening. We may not say that it has peaked out, but the recovery is on and we are also recovering through legal process, but it is only going to be a marginal increase not beyond this.

Nidhesh Jain: Any red flags or any cause of concern in any other business segment on asset quality?

Bhadresh: I do not think so on the MSE front.

Nidhesh Jain: I am talking about other line of business like microfinance or small business loans?

P. N. Vasudevan: There is no trend anywhere else of any concern as of now and even in the MSE if you look at it, basically as Bhadresh was saying if you divide the book of 520 crores into 105 crores of working capital and the remaining around 400 crores of the unsecured BL, the NPA really from the unsecured BL and if you see my lending rate on unsecured BL is around 18%, the yield on unsecured BL is about 18%, so that 18% is factored in for certain level of NPA, so that book has that Rs. 400 crores of unsecured BL keeps reducing over a period of time. The percentage of NPA may look large, but that is not a material point because it is a product that is not being pushed out at this point in time and on the other hand, the working capital is the one which is the focus and there is no concern as far as that is concerned.

Nidhesh Jain: Secondly, on the returns ratio if I look at this quarter, if I adjust for one-off, ROA for this quarter is at around 2%, so is it reasonable to expect that next year ROA profile will be better than 2% plus for the bank?

P. N. Vasudevan: I will leave that to you, but yes all I can say is that fundamentally the business model is something that is very robust model and I think in the previous quarters also we have mentioned that the steady-state ROA of a model like ours should ideally be having a 2% plus ROA 2% to 2.25% kind of an ROA with the ROE anywhere in the range of around 16% to 18%, that is what we have indicated in the past that on a steady state basis, a business model like ours should ideally generate that kind of returns, that is what we have indicated and I think that still remains very much valid and our business model should ultimately help us reach those kind of levels.

Nidhesh Jain: Lastly, on the cost-to-income ratio, so you have guided that cost-to-income will bottom out at around 65% and this quarter already we have reached below 65% if we remove the one-off, so do you think it can inch downwards going forward or it has broadly bottomed out in your view?

P. N. Vasudevan: I think maybe over the next few quarters, we should see it keep trending down because as I mentioned earlier in the previous question also, we should continue to look at growing around 30% to 40% without having to add 30% to 40% of branches or 30% to 40% of staff because we do still have a large opportunity of going deeper in our existing about 500 lending branches plus also opportunities of cross sell which is being leveraged, so the expansion in our branches would be probably 7% to 8% whereas the business should grow at around 30% to 40%, so you will naturally see the cost-to-income ratio trending down over the next few quarters and I think on a steady state basis, we should look at cost-to-income of anywhere around 55% to 60% range.

Moderator: Thank you. We have the next question from the line of Rohan Mandora from Equirus Securities Private Limited. Please go ahead.

Rohan Mandora: Sir, this is regarding the slide on Gaja, Slide #9 and #10, if we look at the data with respect to say the number of installments not paid, zero paid, that portfolio is around 12 crores and three and above is around 5.6 crores and if I come to the next slide in the MF portfolio from 61 to 90 bucket, that number is 5.37 crores so just trying to reconcile both of them because if no installment has been paid for 12 crores and that should be in the 61 to 90 bucket?

HKN Raghavan: The zero installment paid has not completed even that might not fall completely between 60 to 90, there are weekly installments, fortnightly installments. The installments are not equal to let us say 30 days, so there are fortnightly installments, there are monthly installments, so that need not be equally compared to what buckets that we are talking about, so it is what exactly that is being reflected in the slide where 61 to 90 is exactly the path there.

P. N. Vasudevan: The Gaja cyclone hit us on November 16th and it is possible that somebody's EMI might have fallen on November 17th and another customer whose EMI might have fallen on December 15th and December 15th customer having not paid till today would be in the 31 to 60 bucket, so that is why you would not see the entire 12 crores in the 61 to 90 bucket.

Rohan Mandora: Sir, MFI portfolio is what percentage of the amount at an organizational level, would be in the fortnightly repayment cycle right now and then monthly repayment cycle?

HKN Raghavan: Overall, fortnightly would be roughly around 15% and then the balance would be monthly, but whereas in the Gaja hit areas, the repayment mix is slightly different from the all India. The fortnightly would be roughly around 40% and then balance 60% would be monthly.

Rohan Mandora: Sir, just on the interest expense during the quarter, there is a sequential decline, so while the overall liability has gone up, so just wanted to understand that, the finance cost has come down to Rs. 237 crores from Rs. 256 crores, so what all were the components that led to the decline?

Natarajan: We prepaid some legacy borrowing in the fag end of the second quarter, the benefit of which was fully reaped in third quarter, so the high cost legacy borrowings were not there in the third quarter, so to that extent the interest cost came down. Also, if you see the absolute cost in isolation since we reduced the investment book, it was a book which was self-funding in the sense the holding Treasury bills under self-funded through market borrowings, CBLO, Repos, so that was absent in the third quarter, so put together these resulted in reduction in interest cost.

Rohan Mandora: Sir, roughly what would be the impact in absolute terms for these two just to get an idea?

Natarajan: It should be somewhere around 40 to 50 basis points, that has actually contributed to the NIM.

Rohan Mandora: Lastly, you added thousand odd employees in the last two quarters, but employee expenses have been largely flat so where these ground level employees and so there is not much of an impact on the cost?

Sridharan N: The number of employees, Q2 to Q3 has gone up whereas the cost proportionately has not come down. There is a small proportion of variable bonus expenses, which has been adjusted, so that is around 10 crores actually, otherwise, it is 140 to 142 level actually.

Rohan Mandora: Sir, just one comment that was there on Slide 36 with regard to the investment at SLR portfolio, there is no MTM risk on the SLR portfolio whereas we have Rs. 1,715 crores of AFS, so just trying to understand because these are all shorter duration investments and so the possible impact is very minimal that is why that comment or is there something else to read?

Natarajan: The entire AFS portfolio comprises only of Treasury bills and the average duration is about 0.23 and as per RBI guidelines, they need not be subject to market rates, they are valued at cost so in any case impact anyway even if you value at market rates, it will be very, very minimal, insignificant, but anyway we have the comfort of valuing them at cost, so there will be absolutely zero MTM on that.

Moderator: Thank you. We have the next question from the line of Ankit Gupta from Bamboo Capital. Please go ahead.

Ankit Gupta: Sir, just wanted to understand our plans for geographic diversification, so our concentration going forward since we are not growing much branches and let us say around 5% to 8% increase in number of branches, so can we expect this as the concentration in the state of Tamil Nadu will continue like this going forward as well?

HKN Raghavan: There is definitely a plan to reduce the concentration of Tamil Nadu by growing the other states much faster then what Tamil Nadu is growing. We have a plan in place, especially North we have not completely exploited the opportunity which is there at the branches and also some part of the West. Going forward, the growth in West and North will be much faster than the South thereby the concentration of the South especially Tamil Nadu is likely to come down.

Ankit Gupta: Any targets in mind that we want to reduce Tamil Nadu to X percentage let us say next financial year or next-to-next financial year that we have in mind?

HKN Raghavan: Currently, immediately if you look at it at least on the retail mix if you look at it, non-microfinance products we should be able to achieve 30% contribution by non-Tamil Nadu states and that should go up to 40% in the next financial year. We will see how the intervention is, if the actions that we are taking will start yielding results then we will kind of fasten it and then have a target as the year comes by.

Ankit Gupta: Currently, we have 59.35% exposure to Tamil Nadu, so how much do you think this can reduce let us say by end of FY '20 and FY '21?

HKN Raghavan: In the next one or two years, every year we should be able to see that we come down by 5% to 6% and after that year, we should be able to come down by 10%.

Ankit Gupta: Secondly, the question was on expansion into other states where we are currently not present apparently on the Eastern side, any plans for opening new branches there?

P. N. Vasudevan: As of now, no.

Ankit Gupta: We will continue to concentrate on the state we are currently present?

P. N. Vasudevan: Yes, we are present in South, West, Central and North, so principally the focus will be here because we do have a lot of unserved demand even in this areas, so our focus will continue to be here to kind of leverage these markets.

Moderator: Thank you. We have the next question from the line of Kislay Upadhyay from Abakkus Asset Manager LLP. Please go ahead.

Kislay Upadhyay: Sir, I wanted to understand what type of customers do we have on the asset and liability side, as in what sort of overlap do we have and consequently what sort of strategy do we have in terms of customer acquisition and product?

P. N. Vasudevan: On the liability and assets overlap at this point in time, the MSE businesses is the one which is a clear overlap of the customer segment between our asset and liability customers. In terms of our retail lending products such as our small business loans and microfinance, as of now the current liability customer profile is different from the kind of customer profile who borrow from us on microfinance or the small business loans or from the commercial vehicle finance for that matter. The next focus for us is really how do we offer savings product service to small value customers who are principally either our small borrowers or the kind of people from that same community, how do we offer them small value savings account without having to incur a very high cost, so that it becomes possible to sustain that service for a long period of time, so that is the challenge in front of us and Raghavan and his team, they have already rolled out on a pilot basis. In 15 microfinance branches, we have rolled out a desk for the liability products where our microfinance and other small borrowers can open savings or current-account and start transacting on liability transactions, so small values maybe but from our side even though the accounts maybe very small and not very remunerative, but from our side we are seeing that our marginal cost, marginal increase in cost for servicing them should be so small that we are able to afford providing them the liability service even if they have very small balance with us, so that is the whole approach, so that is a project which is already live and as that kind of settles down and proves to be comfortable then we will be owning to scale it up, as we scale it up then the small borrowers also would come and start availing of services on the liability side.

Kislay Upadhyay: Sir, that is in terms of product, in terms of acquisition do we have a different sort of strategy for the liability and asset size, the ones which are not overlapping and some color on that?

P. N. Vasudevan: One thing is that we do not use DSAs anywhere across the bank, so all acquisitions are by our own team, but our own direct staff. We have a sales team for liabilities who go out and acquire new accounts from customers and on the asset side we have our own sales team again which goes out to identify the potential borrowers and bring them to the table, so we have sales team principally which goes out. As we have mentioned earlier, the MSE is one business which is a big overlap from the current liability business, so when a liability salesperson goes and tries to open a current-account, he will also be offering the MSE loan products to the customer.

Moderator: Thank you. We have the next question from the line of Krishnan ASV from SBICAP Securities. Please go ahead.

Krishnan ASV: I just wanted to understand your cross sell, the high potential of cross sell that you see across your customer franchise, where does it typically start given that now you have a product portfolio, where would you ideally start the cross sell, where do you typically acquire the customer, and how does that journey usually take and any early success that you have seen in this?

HKN Raghavan: If you look at the products which is micro-LAP and micro-housing or the first products we introduced some five years back and that product was targeted towards the existing microfinance clients who have the ability to scale up the ladder in terms of higher ticket size loans and if you look at it, our cross sell product is today roughly around 3500 crores in terms of the entire portfolio, so from the microfinance clients if you look at it, the cross sell close to 1.5 lakh clients is what we have crossed sold to these clients in terms of these products, so that is the kind of a scale up that has happened and it will continue to happen.

P. N. Vasudevan: We have nearly about 150,000 used commercial vehicle customers and we have rolled out our new commercial vehicle product about a year back, so that is another area where there is some amount of effort which has been put in place to identify customers who have had a good track record with us and offering them a new vehicle, so that is our second thing that people are working on, we can go on and on but there are significant such opportunities of cross sell as we go forward.

Krishnan ASV: My second question is around your vehicle portfolio, it has generally been sticky in terms of just the quality of that portfolio, we tend to see fairly elevated 90 plus overdue portfolios there, I just wanted to understand what are you doing to improve the overall collection efficiency of just the vehicle finance book?

P. N. Vasudevan: Actually, our vehicle finance, the collection is probably amongst the best in the market and our NPAs in vehicle finance has of course been consistent and it was 6.78 in September and it has come down to 6.25 in December, so there is certain level of improvement but the point really is that these are the used commercial vehicles, which is typically the profile is the driver turning owner and the lending rate in this segment are somewhere in the range of 20% plus and the delinquency of about 6%, 7% or 8% of NPA is kind of factored in from a pricing perspective and the comparable percentage of NPA for used commercial in the market is higher than ours, so anyway that is not to say that we will be complacent, but definitely I think our people have done a great job in terms of managing the quality of our used commercial consistently. Now, over the last maybe three to four years consistently they have been managing a pretty good quality of assets.

Krishnan ASV: My point was to try and understand is there scope to improve this a bit further given that we are at currently about 6.5% and this is broadly priced into how your IRRs and the portfolio are, can this get better is all that I am trying to?

P. N. Vasudevan: From a comparable perspective, if you compare this with NBFCs because there is no bank which does used commercial vehicle at all in India which really means that there are only a few NBFCs who do that. Now, if you look at the NPA of an NBFC compared to that of a bank, there are three main differences. One difference is that in an NBFC when an account touches 90 days and becomes NPA and subsequently it reduces to let us say below 90 days, let us say the 60 to 90-day bucket, it is declassified as an NPA, but for a bank it can be declassified as NPA only when it becomes zero not when it comes below 90, so that is one difference. The second difference is that in an NBFC when we repossess a vehicle for non-payment that goes into stock on repossess stock and it moves away from your loan outstanding and also away from your NPA calculation, but for a bank we do not do that even our repossess stock continues to get added up as part of our NPA book, and third is that we do a daily NPA recognition which is not the standard norm for NBFCs, so actually our figure is not even comparable to NBFCs, but even then our NPA is much lower than the others, but if you ask me whether there is scope to further decrease it, I would not say too much. I think we are probably about at the best possible NPA level, I mean it may marginally keep moving up and down a little bit within let us say a range of 50 basis points up or 50 basis points down over a few quarters, but significantly looking to see that whether that 6% can become say 3% or 4%, I think that is definitely not possible at all.

Moderator: Thank you. We have the last question from the line of Nishant Rungta from Premji Invest. Please go ahead.

Nishant Rungta: Sir, I had one question on the PSLC fee income, do we have another quarter of accrual on the PSLC income of 7 crores pending and what components of the AUM right now do not contribute to the PSL compliance because I think other than the corporate loans if you can help us understand where is it that the 25% drag on the portfolio is coming from because we believe I think the PSL compliant is basically based on your portfolio of the previous year rather than the current year, so we should be running adequate PSL compliant portfolio to generate other income?

P. N. Vasudevan: The fourth quarter, we have 7 crores of PSLC income which is to be booked and also we will have about 6.5 crores of PSLC expenses, which will also be booked in the fourth quarter. In terms of the PSL, the overall book if you look at it there are loans that we give to individuals less than Rs. 10 lakhs which are secured by house property, these are typically the microfinance, what Raghavan explained earlier, micro-LAP which is a product which is given to the top end of the microfinance customers. The loan sizes are typically less than 10 lakhs, 4, 5, 6 lakhs, it is always less than 10 lakhs and secured by their house property, so that book is a non-PSL category, so that will be the largest non-PSL book, but minus that practically every other part of our loan book will be of PSL category. Corporate loans of course there would not be, but corporate loans will always be in the range of 4% to 5%, but the significant contribution really is this individual LAP that we give small ticket LAP to the top end of the MFI customer which is less than Rs. 10 lakhs, which will not be a PSL book.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, that was the last question. I now hand the conference over to Mr. S. Bhaskar for closing comments. Sir, over to you.

S. Bhaskar: Thank you. On behalf of the management, I thank all of you for the interest in our performance and also for joining the call. We look forward to your continued interest and participation. 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 with us and you may now disconnect your lines.