Equitas Holdings Limited Q4FY17 and FY17 Earnings Conference Call

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MANAGEMENT: **MR S BHASKAR – EXECUTIVE DIRECTOR AND CHIEF EXECUTIVE OFFICER, EHL**
MR P N VASUDEVAN – MANAGING DIRECTOR, ESFBL
MR T S NARAYAN – EVP & HEAD – TREASURY, ESFBL
MR H K N RAGHAVAN – PRESIDENT, INCLUSIVE AND OUTREACH BANKING, ESFBL
MR VS MURTHY – PRESIDENT, EMERGING ENTERPRISE & SME BANKING, ESFBL
MR N SRIDHARAN – CHIEF FINANCIAL OFFICER, ESFBL
MR S VASUDEVAN – CHIEF FINANCIAL OFFICER, EHL
MR M DHEERAJ – VP AND HEAD – STRATEGY & INVESTOR RELATIONS, ESFBL

EHL: Equitas Holdings Limited

ESFBL: Equitas Small Finance Bank Limited

Moderator Ladies and Gentlemen, Good Day and Welcome to the Equitas Holdings Limited Q4FY17 and FY17 Results Conference Call. We have with us today Mr S Bhaskar – Executive Director & CEO, Equitas Holdings; Mr P N Vasudevan – Managing Director, Equitas Small Finance Bank; Mr T S Narayan – EVP & Head - Treasury, Equitas Small Finance Bank; Mr H K N Raghavan – President - Inclusive and Outreach Banking, Equitas Small Finance Bank; Mr VS Murthy – President - Retail & SME Banking, Equitas Small Finance Bank; Mr N Sridharan – Chief Financial Officer, Equitas Small Finance Bank; Mr S Vasudevan – Chief Financial Officer, Equitas Holdings Limited; and Mr M Dheeraj – VP & Head - Strategy & IR, Equitas Small Finance Bank.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr Bhaskar. Thank you and over to you, Sir.

Bhaskar S: Thank you. Good afternoon, everyone. And thanks for your continued interest in Equitas. FY17 was an eventful year for the Group, with the commencement of banking operations. During Q4, the rollout of banking operations progressed well with 284 liabilities branches operational by 31st March 2017 as against 110 branches as of 31st December 2016. Conversion to bank helped us to reduce cost of funds. Demonetisation had some adverse impact on our advance portfolio, especially in Micro Finance lending. On a consolidated basis, our advances under management grew by 17% over last year. PAT for the year was ₹ 159 crore, which was 4.7% lower than FY16.

To take you through the details, I now hand over the call to Mr P N Vasudevan to go through the Bank's performance.

PN Vasudevan: Thank you, Bhaskar. Good afternoon, everyone. During the last year we got listed, some of our subsidiaries merged and banking operations commenced. We have now rolled out 284 bank branches; we have recruited about 3,200 staff for the liability side. We also launched three new lending products and along the way we sailed through some rough weather post demonetisation. And in spite of all that we have done reasonably well in terms of our AUM growth over the previous year.

Just to give you some details about used commercial vehicle finance and micro loan against property, where we give loans from ₹ 50,000 to ₹ 5,00,000 against the security of a house property. Both of these have clocked good growth. The used CV finance has grown at about 27% and the micro loan against property has grown at about 50% over previous year. Both these products have registered a CAGR of over 50% for the last three years. Asset quality of these two products are well maintained. GNPA is about 0.2% for micro loan against property and about 6.4% for used commercial vehicle. We are confident that these products will continue to grow and fulfill the needs of under banked and financially excluded segments of the country.

We have also launched three new products: business loan, agricultural loans and gold loans. We are seeing some green shoots and right from the beginning, their traction has been pretty good. In three months since launch, these three products, put together, have crossed an AUM of over ₹ 100 crore.

As far as housing finance is concerned, we are still doing a lot of changes in the way we roll it out. Currently we are hardly present in about 10 - 12 branches where housing finance is being offered. We are now changing that and will roll it out through our inclusive banking channel in about 50 - 60 branches.

On the liability side, our journey has been very promising. As on date we have opened around 310 branches. As of March, our deposits stood at ₹ 1,900 crore, which is about 28% of our total borrowings and CASA stood at 17%, which we believe, is pretty good for three to four months of banking operations.

We have also started cross sale of third party products like insurance and mutual funds. These streams of revenue are expected to improve in the coming quarters.

On digital banking, most of the services are now available digitally to our customers. Our wallet, which is called 'Purz', has been recently rolled out while our UPI platform is likely to be rolled out shortly. Our internet and mobile banking is available for individuals and corporate net banking is likely to be rolled out in the next one to two weeks. We are also certified for issuing FASTag RFID sticker for electronic toll payment on highways. We are the sixth bank in the country to do so.

With both advances and liabilities products increasing, we have divided the SFB into various verticals as shown in slide five. This move will also help the verticals to focus on their core offerings and drive synergies across the enterprise. And going forward, we hope to provide you business updates along these verticals.

On branch expansion, as informed earlier, we had obtained the licenses to open 412 bank branches. Out of this we expect 375 to be up and running by September 2017. We are awaiting RBI's final guidelines on branch licensing policy, which is expected shortly.

The draft guidelines, as you might have read, says that Business Correspondents who are connected to main CBS of the bank through an online terminal are likely to be reckoned as a banking outlet. So, we are awaiting final guidelines on this policy and we will be basing our future branch expansion accordingly.

We expect to not open the remaining 37 branches out of the 412. We had initially planned for another additional 80 branches during 2017-18, which may also not be opened up. Instead, we might use the BC channel to reach further into the market.

Liability accounts for our borrowed customers has not been the focus so far. When BCs become operational, we would open accounts for our borrowers located in the respective BCs area. BC channel would be the main channel to open accounts and service banking requirements of our borrower customers. Since, we believe that they will find it more convenient and comfortable to deal with our BC outlets which are likely to be very closely located to their neighborhoods.

Now coming to the impact on Microfinance, slide numbers seven to sixteen, we have provided lot of details on the entire Micro Finance portfolio. As you would have noticed, while we continue to do better than industry's PAR across buckets and regions, we are still quite concerned with this level of deterioration. Collection efficiency for the quarter stands at 95.4%. While more than 90% of our customers continue to pay on time, about 7% of our customers who have not paid on time have rocked the boat, showing how sensitive this product is to our profitability.

In order to de-risk our portfolio further, we are looking to reduce the weight of Micro Finance from current levels. Currently, Micro Finance contributes about 46% to the total advances and we expect this to go below 30% by March 2018. This is reflected in our disbursement in Micro Finance in Q4 which was about 40% - 45% of our pre-demonetisation levels of disbursements. Also, a good point to note is that post demonetisation, 100% of all our disbursements in Micro Finance has been through bank accounts only and we have completely stopped giving disbursements by way of cash to clients. Our focus is largely on repeat Micro Finance clients.

To sum up, our overall rollout of liability branches and deposits has been in line with our plans. Existing loan products of commercial vehicle finance and loan against property are expected to continue to grow well. The three new products introduced during the year are expected to support overall portfolio growth. Even though Micro Finance portfolio is expected to reduce sharply during the year, we still expect overall advances book to grow by about 15% - 20% during FY18. In terms of our treasury, we expect our cost of fund to go down further during this year as we end up re-pricing some of our old borrowings. Our CPs will all be maturing during the second quarter - by September of this year, which should get re-priced. Half of our NCDs also mature for repayment during the current year, which would also get re-priced. And as we replace some of these older borrowing with low cost deposits, we expect our cost of funds to go down further during the current year. And our fee income from sale of priority sector loan certificate is also expected to improve overall other income of the Bank.

With that, I now hand over to CFO Sridharan to take us through the financial numbers.

N Sridharan: Thank you, Mr Vasudevan. On the financials, NII for Q4 FY17 grew by 30% on year-on-year basis and for financial year 2017 it grew by 42.3%. AUM as of March 2017 was at ₹ 7,176 crore as compared to ₹ 7,180 crore as of December 2016.

PAT for Q4FY17 was at ₹ 6.9 crore, against ₹ 44.9 crore for Q3. The fall in profits is attributable to higher operating expense, due to liability branches rollout and to the adverse impact on treasury income from increase in yields on G-Secs. On comparison of PAT for Q4FY17 against Q4FY16, the impact, in addition to the earlier mentioned reasons, was also due to credit cost on MF portfolio.

As mentioned in our presentation, as on 31st March, 2017, we have impaired MFI portfolio of ₹ 58.2 crore as NPA which was otherwise not an NPA as per RBI norms. Against this portfolio, on a conservative basis, we have created a provision of ₹ 35.8 crore; and out of this ₹ 20.8 crore provision was made in Q4.

GNPA as of 31st March, 2017 stood at 3.5% as against 2.46% as of 31st December. The spike is attributable entirely to additional MFI impairment as mentioned above. GNPA for the rest of the advances book has marginally come down to 4.40% in March 2017 as compared to December 2016, which was 4.42%.

With this, I hand over the session to the moderator for question-and-answer. Thank you.

Moderator: Sure. Thank you very much. We will now begin the question-and-answer session. We have the first question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal: My question is first on the credit cost for FY17. We have a total credit cost of ₹ 103 crore against ₹ 59 crore. We have now identified portfolio of ₹ 58 crore and made a provision of ₹ 35 crore. How do you see the credit cost for the business in FY18 considering the MFI and other pieces are growing faster?

PN Vasudevan: See, on the products other than Micro Finance, as we mentioned earlier, our GNPA has actually come down marginally in March compared to December quarter. The portfolio quality stability has been pretty comfortable. Going forward in terms of GNPA of products other than Micro Finance, we hope they will continue to remain quite under control.

As far as Micro Finance is concerned, we have identified certain level of assets as potential stressed assets for which we have recognized them as NPA and made a provision. On the remaining part, we have given you all the details in terms of various buckets and various analysis. It is available in the presentation. In terms of whether any of them will further slip into stressed category is something that we will have to wait and watch and depends on how the portfolio performs during first quarter of current financial year. So only at the end of current financial year we will have a definitive idea in terms of how much of the portfolio has been paid back and come back to normal healthy book and how many customers are actually slipping further into either stress or NPA. That is something we will know only by end of the first quarter. But data in terms of all the cuts are available in the presentation.

Manish Ostwal: So as against impact on portfolio of ₹ 58 crore, we have provision of ₹ 35 crore, will the balance provision be done in quarter 1 or how would we take a call on that?

PN Vasudevan: Yes, if ₹ 58 crore does not show any improvement, the balance will have to be provided for in the first quarter.

Manish Ostwal: My second question is on OPEX growth. The full year OPEX growth is 71% and by September 2017 we will be reaching to branch network of 375 from 284. How do you see OPEX growth in FY18 given the branch expansion pace?

PN Vasudevan: Most of the recruitments are already completed, because these branches are at various stages of commencement of operations. But some of them will be joining in this quarter. So, as we had mentioned in previous quarter call also, we expect first quarter of this current financial year to be the peak in terms of our cost and after that cost should more or less stabilize.

Moderator: Thank you. We have the next question from the line of Anirban Sarkar from Motilal Oswal Securities. Please go ahead.

Anirban Sarkar: I needed a clarity regarding the portfolio of ₹ 58.2 crore in Micro Finance which you have recognized already and you have said that you have made a provision of ₹ 35.8 crore. So, what part of that ₹ 35.8 crore was made in Q42017, was it the entire part or was it one part of it only?

N Sridharan: Out of the ₹ 58.4 crore, we made ₹ 15 crore provision in last quarter and the balance ₹ 20.8 crore has been provided in the current quarter.

Anirban Sarkar: So ₹ 15 crore in the third quarter and the remaining ₹ 20.8 crore in fourth quarter?

N Sridharan: Yes, Q4.

Anirban Sarkar: And Sir, the other question is regarding the breakup of disbursements across your products. Can you provide us that?

PN Vasudevan: See, from this quarter we are not really giving too much of product-wise details because there have been three more products which were introduced and going forward there may be one or two more which might come in time. So, we are just looking at it as retail banking. Hence, you will get a lot of information at the retail banking level with certain level of information drilled down at product level.

Anirban Sarkar: And my last question is regarding your loan breakup. We have the AUM breakup by product, so if you could provide us the on-book breakup by product, that would be great Sir.

N Sridharan: The on-book advances breakup: Micro Finance - ₹ 2,705 crore, UCV - ₹ 1,617 crore, MLAP - ₹ 881 crore, and LAP - ₹ 236 crore, Home Loans - ₹ 264 crore and others constitute - ₹ 127 crore, totaling to ₹ 5,829 crore. And others include business loan ₹ 63 crore, OD ₹ 61 crore and other loans ₹ 3 crore.

Anirban Sarkar: Okay. So just to make sure, UCV is ₹ 1,700 crore you said?

N Sridharan: ₹ 1,617 crore

Moderator: Thank you. We have the next question from the line of Rahul Ranade from Goldman Sachs. Please go ahead.

Rahul Ranade: Just looking at your presentation, on slide 16 bottom left we talk about the GNPA product-wise trend. Just wanted to understand why home finance GNPA is so high in spite of it being a secured product?

PN Vasudevan: Yes, because the portfolio has not really grown at all, it has remained kind of flat, so even a small numerator increase changes the percentage substantially. Home loan has not really been a product which we have grown in the last, may be, two years or so. Now, as I said in my earlier commentary, we are kind of reinventing home loan. We are running it now through inclusive banking channel and we expect to open it up in about 60-odd locations through existing inclusive banking channel team, compared to the way it was being done earlier. So, increase in percentage of NPA is all very theoretical, because the portfolio itself has remained very small and the denominator has hardly seen any growth.

Rahul Ranade: And just on the same chart actually, the dotted blue line which is kind of written as LAP which in Q4FY17 is at 7.2%, so just want to know what that is actually?

VS Murthy: Similar to housing finance, earlier we were offering LAP product to customers without income proof. We have seen stress in that segment because there is no vintage of customer's repayment tracking and all. Hence we had to slow down that vertical. Now continuing to main segment, through our liability branches, we plan to cater to the segment of customers with income proof. So similar to housing, the last two to three years there has not been much growth in LAP. For example, if you see in absolute numbers in Q4 number of NPA accounts got added is around just 20, but percentage wise it looks quite high because the denominator is very, very small. That is the only reason.

Rahul Ranade: And what is the difference between micro-LAP and LAP? Ticket size, is it?

VS Murthy: Exactly, yes.

Rahul Ranade: So what are the ranges of ticket size getting accounted for in both?

HKN Raghavan: The micro-LAP is ticket size from ₹ 50,000 to ₹ 5 lakh, and the tenure is three to five years whereas General LAP would be more than ₹ 10 lakh and generally the tenure is between ten to fifteen years, so that is kind of difference. Ticket size goes from ₹ 10 lakh to even ₹ 1 crore.

Rahul Ranade: In the LAP?

HKN Raghavan: Yes.

Rahul Ranade: Just returning to Micro Finance segment, basically on your remark of taking the Micro Finance loan portfolio down to below 30% of the overall portfolio. How are we planning to do that? Will we stop taking new customers and lend to the existing people? Can you throw some light on the same?

HKN Raghavan: What we have done is that vintage customers who have been with us for at least one cycle, we continue to fund them. We are not funding any new customers and continue to fund the old customers who have been with us. So that comes down around to the conversion rate of second cycle loan, which is roughly around 45%, out of which 40% is the one which we are disbursing now.

Rahul Ranade: And going ahead, once you reach below 30% by FY18, will we kind of keep it at that level, below 30%?

HKN Raghavan: Again, in this case what we have done is that none of the branches will stop doing Micro Finance. We will continue to do Micro Finance and in terms of below 30%, we will need to see how it will settle down. At this particular point of time to tell where it will settle down is difficult. But going by the current rate of disbursement, we expect it to be below 30%. Because we expect between three to six months to see how the industry will settle and how things are going to be in terms of repayments.

Rahul Ranade: So we are not saying that we will go back to the growth rates that we were achieving prior to this whole demonetisation thing, not closing that option basically?

PN Vasudevan: See, we are not closing any options. Obviously, we do not want to close any options, I mean, you never close any options permanently. But the point is basically that from a risk perspective we want to have a diversified book and at some time Micro Finance as well as any other product should only be contributing a certain percentage so that your portfolio is well diversified and to that extent risk is reduced. At what level that will be is something that we will keep reviewing and take calls as we go by. But we would not like any product to be having a big overhang on the portfolio, whatever be the product.

Moderator: Thank you. We have the next question from the line of Dhawal Gada from Sundaram Mutual Funds. Please go ahead.

Dhawal Gada: First question is on slide nine. There is one chart of collection efficiency, billing efficiency rather. I just wanted to understand, since we are on 8th May right now, so what is the April billing starting point? It was 94.4 in March, so what is the number for April?

PN Vasudevan: Well, I do not have that data and I am not in a position to give you at this point of time.

Dhawal Gada: But would it safe to say that it has improved versus March and February, or it would not be too different?

PN Vasudevan: It will be safe to say that.

Dhawal Gada: On slide 12 you have put a table of first time overdue customers. That number has been coming off gradually from January to March. So I just wanted to understand again here in April how are the incremental trends looking like? And overall, right now our PAR from the new set of customers or first time defaulters stood about ₹ 173 crore odd, so where do you see this number stabilizing for us, if you can give us, broad range would be very helpful.

PN Vasudevan: See, as you can see the trend, the sharpest increase was in the months of December and January. Subsequent to that, if you see the increase has tapered down in the month of February, and further tapered down in the month of March and the trend has been the same. April month also has seen a further tapering down of that trend and we really hope that slippages stop somewhere down the line, but trend is definitely in that direction.

Dhawal Gada: Sir, then moving on to the new products rollout, while the initial trends are really encouraging, I just wanted to understand how many branches are we starting on agri loan, gold loan and business loan side? And how big these three products could be in the next may be two to three years in terms of portfolio mix?

HKN Raghavan: In terms of agri loan, we have started in close to 150-odd branches of the inclusive channel. Business loans, we have started in 75 branches of the inclusive channel and the business loan channel itself has some 25 branches; so totally 100 branches in terms of business loan. In terms of loan against gold, 150-odd branches have started in the first phase. As of now, if you have seen those numbers clearly, ₹ 100 crore of portfolio has been generated in these three particular products and we see a lot of potential in these products and the coming quarters will have a good traction as far as these products are concerned.

Dhawal Gada: Can these three products combine the 15% to 20% of AUM in next three years, broadly?

PN Vasudevan: Yes, see all these products have a high potential, demand is quite good in the market and the level of servicing, the level of products available from other bank and competitors is not fully meeting the demand. So, there is a lot of unmet demand in the market for these products. In terms of how much this will contribute, I think it will be a decent contribution to the whole book in a matter of two to three years. I do not know, if you ask me whether it is 15% or 25%, at this point, I would not really give a guess on the percentages. But yes, the potential is definitely very high on all these products.

Dhawal Gada: Sir, just lastly on term deposits, I just wanted to understand what is the mix between retail and wholesale within the term deposit?

HKN Raghavan: In terms of deposits, ₹ 1,900 crore is the total deposit, out of which 17% is CASA. And then close to ₹ 500 crore is the retail deposit and balance is the wholesale deposit.

Moderator: Thank you. We have the next question from the line of Sumit Chaudary from Vada Capital. Please go ahead.

Sumit Chaudary: Sir, just a couple of questions on the Micro Finance bit. So, if I look at slide 10, it seems your portfolio at risk has been increasing consistently every month, if I look at the chart on the bottom left. The picture is quite divergent from what the trend we see in other MFI companies. So if you could explain why could that be? And second, just looking at slide eight, essentially the chart on bottom right, if you look at the customer indebtedness, there are 20% of borrowers who are three or more lenders. So considering the two MFI cap, just wanted to understand how could we get into a situation where we have 20% borrower with three or more lenders?

PN Vasudevan: What was the first question, you will have to just repeat the first one.

Sumit Chaudary: What I am saying is, in your portfolio at risk, PAR zero number is going up every month; whereas if we look at the other Micro Finance institutions for instance, they are actually seeing PAR zero number go down every month. So, just wanted to understand what is causing this divergence?

PN Vasudevan: See, if you see our PAR zero, it was ₹ 176 crore in January and went to ₹ 186 crore in February and then ₹ 194 crore in March. There has been a marginal increase in the PAR over the last two months but the increase of course has come down substantially compared to December and January. If you see our overall PAR level, itself is less than maybe 25% of the level of the industry, because the average of the industry PAR is actually about 20%, whereas ours is about 5%. So, the overall slippages have been low and to that extent yes it is not very comparable from the rest of the industry. And the level of slippage month-on-month has come down which is a big relief to all of us out here.

As far as the second question is concerned in terms of number of lenders to borrowers, there are two factors which can be the reason for this. One is that banks who are also lending to the same borrowers under the same format of joint liability group, they are not counted for RBI's requirement of two MFI per customer, so typically bank loans would be the extra loan. But we have not gone technically with the NBFC-MFI and bank classification. Just for our business purpose we have just taken any lender as an institution so that would be the one main reason why there would be more than two institutional lenders to the borrower. The second reason would be that, in spite of very good credit bureau record and decent level of quality of data of all the MFIs who are uploading data to the bureau, there is still 5% to 10% slippage in terms of accuracy with which we are able to download our report and match customers. So, that does lead to a small percentage of customers where the credit bureau is not able to catch it and filter it out correctly.

As some of you may know, MFIN, which is association of MFIs, had come out with a lot of guidelines on this long time back and all MFIs have been trying to do their best to kind of improve their quality of data which they provide to the bureau. And today MFIs have almost 95% Aadhar seeding in their data base. So, today if you are able to query with an Aadhar number, the level of accuracy you get is of course 100%. But again, the point is that, the Aadhar seeding is about 95% of the industry level, which still means that that 5% slippage can always occur. So this will be the reason for more than two institutions per customer.

Moderator: Thank you. We have the next question from the line of Sangam Iyer from Subhkam Ventures. Please go ahead.

Sangam Iyer: Given that we are moving away from Micro Finance into other categories, how should one be looking at the NIMs going forward? Will we have lower yield as compared to Micro Finance yields?

PN Vasudevan: Yes, the lending rates of some of the newer products will be lower than typical Micro Finance loans. So there could be an impact as far as NIM is concerned. But then in parallel, as I mentioned in my opening remarks, we expect cost of funds to also reduce during current financial year compared to the previous year. This is because a lot of our old borrowings in the form of CPs and NCDs will be maturing for repayment this year and getting replaced with deposits which should be definitely at a lower cost. So there will be a positive impact as far as cost of funds is concerned and a negative impact because of lending rates being lower in other products. So by and large, we expect some level of decrease in the NIM. But to some extent it should be supported by the cost of funds going down. However, we expect the operating cost of newer products to be lower because of the ticket size being much larger than a typical Micro Finance loan.

Sangam Iyer: So given that, in the initial two years, I mean 2018 and 2019, can we arrest the decline in NIMs to be 100 basis points at the worst case? Would that be a fairer assumption to make?

PN Vasudevan: I think that is a reasonable assumption. I would not want to say very strongly yes or no to that question; I do not want to project something to the future as sharply as that. But I think yes, broadly we should be able to be in the range that you are indicating.

Sangam Iyer: So as you said, incrementally your opex would not be that high in terms of cost of acquiring those customers. How should one be looking at the cost to income ratio? This quarter it was at around 80%. So, given that, we have couple of more quarters where the branch expansion process would continue and then we will see the leverage coming in so, how should one be looking at the cost to income ratio for the next financial year?

PN Vasudevan: I think 80% maybe very close to the peak that we expect to hit because as we said earlier most of the staff for the remaining liability branches are already on board. So cost is already there on the books at this point in time and future branch expansion, as I have mentioned earlier, we are putting that on hold because we want to study the new guidelines as and when they come out from RBI. We believe that the BC-led banking outlet model is something we would like to really focus and drive very sharply. The incremental expansion cost I think is going to be much lower. So, I think by and large, we are very close to what the peak is likely to be.

Sangam Iyer: And Sir, just on the borrowing mix, could you give us some color on how the borrowing mix could be for when we exit FY18?

TS Narayan: Coming to the borrowing mix, our customer deposits, retail as well as bulk would increase. Also, after getting the schedule status, we are in a position to tap the CD market for funds up to one year. In addition to that, after getting the schedule status we are also in touch with banks and we will be getting adequate banking money market lines. So, to that extent actually our dependency would be reducing in terms of bulk raising, slowly we would be moving towards more customer deposits.

Sangam Iyer: On the credit cost front, how should one be looking at it? You said that only ₹ 21 crore that is pending on the Micro Finance front where you are seeing it more being vulnerable.

N Sridharan: The credit cost at present for FY17 is at 2.03% and is likely to be around 2% for the current financial year – FY18.

Sangam Iyer: Just going back to your slide nine, where we have collection efficiency chart. I just was trying to understand this chart wherein from December 2016 to March 2017, when we look at the initial start off, the collection efficiency has been progressively coming down from 96% odd to 94% odd. I am trying to understand here that isn't this a sign of deterioration in the overall collection efficiency that we are talking about here?

HKN Raghavan: Initially in the month of November and December we were allowed to collect the SBNs till 31st of December. Hence, compared to the industry we are on a higher platform as far as collection is concerned. And post December, collection of SBNs was not permitted. So that is where you will find that gap of 1% coming down. Though it is not drastically down, the incremental situation at the ground level are different… because it started as a demonetisation impact and post December, it took a different turn in terms of loan waivers and local elements coming into the picture and various things. So, the reasons are completely different. But even otherwise, if you look at it, at least 2 to 3 percentage points we are a lot better than industry and other banks.

Moderator: Thank you. We have the next question from the line of Aseem Pant from HSBC. Please go ahead.

Aseem Pant: Sir, just a couple of questions. One is on slide eight, the bottom right table wherein you talk about the customer indebtedness, analysis of recent defaulters and 'only Equitas' is at 41%. How do you interpret this? What should be the takeaway for us from this? Does it mean that there is saturation in terms of new borrowers or does it mean that these people do not know the value of MFI, how do you view this?

PN Vasudevan: See, right from the beginning we have had this policy that even RBI's rule was two MFI per customers, and banks are not included in that list. And so, typically an MFI could still be giving a loan to our customer even though she might have borrowed from, let's say, one MFI and one bank or two banks. So, effectively she might have borrowed from three institutions. But we used to regard the fact that banks have also lent money to the same kind of customer, so we used to count it in the number of institutions. If she has borrowed from one MFI and one bank, for example, then we would treat her as being ineligible for our loan so we were not giving our loan to her. And because of this our repeat cycle - if you can go through our June and September quarter Investor Presentations we have mentioned there that our repeat business, because of the particular policy that we have, was as low as 40% in a market where typically the repeat business is not less than maybe 70% to 80%. The reason is because at the end of two years of our loan when we go back to the customer we figure out that she has already borrowed from one or two banks and one MFI, and that makes her ineligible. Because of this we always had to go out and look for customers who had not borrowed from anyone else to be able to fund. So we used to have 60% of our fresh loans going to first time borrowers who had not really borrowed from anybody else. This really reflects that 41% of our old customers have loans only with us. This is in a way comforting to us, because she is not exactly struggling and she is not exactly overburdened with multiple loans. And today she is not paying me, maybe because of lot of local influencing factors, but as and when she begins to see the benefit of maintaining credit history properly and is able to get away from local winds of influence that is blowing over her. The moment she is able to get away from that and she thinks that she wants to repay her loan, she will be able to repay it because she has got only our loan and does not have any other borrowings. I think, we take it as a very positive factor in the medium-term that as and when client decides to come back and be better in repayment, ability should not be a hindrance for her because she is not overburdened with multiple loans.

Aseem Pant: I mean, I was just wondering, if maybe there is some kind of a saturation and whatever new clients you might be getting might not be lendable to begin with, or maybe they have borrowings from informal sources which are not captured by the credit bureaus.

PN Vasudevan: No, the demand for Micro Finance continues to be very high in spite of whatever level of growth of MFIs in the country, the unserved demand on Micro Finance still continues to be anywhere in the region of about 40% - 50% to 70% - 80%, depending on the geographies. So there is no dearth of demand and there is no dearth of potential customers, it is only up to us to go out and find them.

Aseem Pant: And then secondly Sir, in terms of the new products, the gold loan, agri and the business loan, could you just delineate what is the competition like in these segments, what is the customer segment that you are targeting and who are your competitors there?

HKN Raghavan: As far as business loan is concerned the ticket sizes are mainly below ₹ 25 lakh and this particular segment is not well penetrated, hence we see a lot of potential. Many clients would be availing loan for the first time, so it is in line with the kind of segment that we are very well aware of and have a relationship with them. Good opportunity exists for this lending. As far as loan against gold is concerned, it is very clear: we have close to 2.8 million clients and our internal survey says that close to 60% of them are taking loan against gold with the non-banking sector, which would be an opportunity for us to tap. Agri loans, again, the segment in which we operate, we sit on a huge opportunity because most of them operate in the agri chain, whether it is milk or whether it is sugarcane, I think most of them operate in the agri chain so we have a lot of opportunity to tap this channel. So I think we are very well aligned in terms of our distribution, reach and the products which are placed. Overall it is a good opportunity for us.

Aseem Pant: And Sir, finally just one small clarification, can you explain why the capital adequacy ratio has increased quarter-over-quarter, any specific reason?

N. Sridharan: The capital adequacy ratio has increased from Q3 to Q4 because RBI guidelines allow us to take profit after tax only after the audit is completed. That is, in Q3 we could not take the PAT whereas in Q4 after audited results we are able to consider the PAT for capital adequacy calculation. That is the reason.

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

M.B. Mahesh: Just a couple of questions. One, to Mr Raghavan, any broad understanding as to why are only the first cycle borrowers showing reasonably high amount of default as compared to people who have gone through a couple of cycles? And what specifically is the problem that you are facing in Bangalore?

HKN Raghavan: I think first one is that our understanding as far as the new client is concerned was coming on board; the bonding is not that strong compared to what happens to vintage customers. What happens is that you are in the company of people who have kind of finished first cycle, second cycle; you know there is a behavior, always a kind of an orderly kind of behavior in a group. But in the first cycle what happens is that the leadership does not mature and does not become strong, and that is one of the reasons why you find most of the first cycle defaulting and they waver. So that is the understanding that we have. Second, in terms of Bangalore, it started in the month of December itself, for the whole industry, there were focused pockets like central Bangalore and other places where default has been very high. As far as the industry is concerned you will find that Bangalore industry PAR is about 52% and our PAR is about 34%. In fact Bangalore we have only 10 branches while peers would have at least three times of what we have. So we were pretty cautious in Bangalore; in certain areas we did not venture at all.

From a risk assessment part we said central Bangalore we will not be there in many of the areas which we considered could be risky. So that probably could have helped us in terms of kind of having a lesser impact as far as PAR is concerned.

M.B. Mahesh: Okay. The second question is, on your securitised portfolio, how are the provisions on that particular book, how should we treat any defaults there, should we take it immediately into next quarter or do we wait for some time?

N. Sridharan: See, as far as securitisation is concerned, the provisions are taken as and when it arises because we normally provide over and above the collection, also the extra interest as well as we provide a cash collateral. So after meeting all these things if there is a default, then only we take into our provision, otherwise the extra interest takes care of it. Whenever the cash collateral is adjusted that is taken to the profit & loss account as and when it is occurring.

M.B. Mahesh: Sorry, I just might have to squeeze one question, just on the growth side. You had indicated that your overall growth is about 15% in FY18 that would translate into MFI book probably reporting a marginal decline. Just trying to understand how dependent is your business model now on the Micro Finance business customers to your other parts of the business? Are you engaging them in any ways to get them into the individual lending model and is there a risk here of reducing it?

HKN Raghavan: See, in terms of one product which is micro-LAP which is a cross sell to the Micro Finance clients. And number two, loan against gold is also looking at a future opportunity and it looks promising for us to tap these particular two products. And two things, one is that over a period of last eight years we have had a very good mapping in terms of the villages and coverages that we have. And in parallel what is happening is that we are also looking at expanding our BC network into these villages, so that in case there are couple of villages or towns which we are not covering, what happens is that we will be able to tap this particular product through this particular agency. The other thing is that, the kind of scale up that has happened in the last four to five years, the customers are very well aware which number to call, where to approach for these particular product lines. So to that extent, I think we will not feel that gap, but otherwise also we will look at campaigning and also looking at certain toll free numbers where people can immediately call and then get connected for these particular kind of loans.

Moderator: Thank you. We have the next question from the line of Rajatdeep Anand from Canara HSBC Life Insurance. Please go ahead.

Rajatdeep Anand: Sir, I have few questions. First one being, if I go through your quarterly presentation, I see CASA in Q2 was 1.8, Q3 was 12.6 and now it is 17.5. So, broadly what is the strategy on this and how can we look at this going forward? Then I see on slide 18 itself the term deposit number is given, but what is the retail term deposit out of this? So if you are having 17.5 CASA, are you having about 10% of retail term deposits already? And there is a very broad ROE guidance of 16% to 20% you have given, so obviously the band is wide but this will be a linear progression or this will be something more back ended?

PN Vasudevan: So, in terms of CASA growth, yes obviously, there is lot of focus on CASA, and touchwood, the initial response to our offering in the market has been very good and that is why we have been able to have a pretty good growth in terms of the CASA balances and the CASA percentage. Going forward, we do continue to hope to be a very strongly CASA led deposit bank. In terms of the breakup between retail and wholesale deposits, retail deposits which means deposits of less than ₹ 1 crore is approximately about ₹ 500 crore. 17% of ₹ 1,900 crore, which makes it about ₹ 330 crore, is the CASA. And the remaining which is approximately about ₹ 1,100 crore is the wholesale deposits. The ROE guidance is obviously for the medium-term of three to five years that needs to build up as we improve our ROA and as we leverage through growth in our advances, it will have to build up over the next may be three to four years' time.

Rajatdeep Anand: Right. Can I just ask you what is the retail term deposit of the total term deposits?

PN Vasudevan: It is about ₹ 500 crore of retail term deposits.

Rajatdeep Anand: Finally on this, you talked about this BC driven model for retail, can you help us understand this model in more detail?

PN Vasudevan: I mean, you will have to really read the draft guideline of RBI, which is there on branch licensing policy. The draft guidelines does talk of business correspondent who has a terminal and is connected online to the CBS of a bank being regarded as a banking outlet. So we are just awaiting the final guidelines in this regard from RBI. So when the final guidelines come, we will kind of have to work our strategy to take our reach out in to the hinterlands through the BC model, based on how the final guideline turns out to be.

Rajatdeep Anand: It is that you have in terms of deposits and everything, that is sourced through branches right now or it is more of a BC kind of mobilization that you have got?

PN Vasudevan: No, right now it is 100% only branches.

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

Nidesh Jain: Sir, first question is on the liquidity on the balance sheet, in this quarter we have seen the proportion amount of cash and amount of investment going up quite drastically. So what is the sustainable part of liquidity on the balance sheet, is it a sustainable number or we expect this to come down over a next few quarters?

TS Narayan: Yes, current liquidity is considered adequate, because what we have done is towards the close of March we raised funds via the IBPC route, which was close to about ₹ 300 crore which came at a very low rate. In addition to that, we have kept liquidity for some repayments which were due in the first week of April; plus some callable NCD borrowings. So we kept liquidity for that as well as we have kept some liquidity buffers for maintenance of SLR as well as provision for disbursement for one to two months. So, that is the thing which we consider adequate.

Nidesh Jain: So, next quarter onwards it should come down?

TS Narayan: We will progressively maintain a modest liquidity to take care of all exigencies and even plan for future disbursements also.

Nidesh Jain: Secondly Sir, you have given us growth guidance of around 15% to 18% for FY18, can you throw some light on FY19 sort of growth, what one should expect growth for 2019?

PN Vasudevan: Please help us finish of this year then I will come back to you.

Moderator: The next question is from the line of Kaustav Bubna from SKS Capital. Please go ahead.

Kaustav Bubna: So, what I gathered from this call is higher opex even though it was stagnated around 80% cost to income, and also reduction in your MFI portfolios. Shouldn't your ROEs be lower in FY18 than this year? And if not, could you explain why and what would your target be for next year FY18?

PN Vasudevan: Well, the ROE will be a factor of the leverage obviously, so we have to see how our advances growth happens during the current year. If we are able to grow the advances well this year and leverage the capital better, that should really help improve the ROE for the current year. So, I think we have to just wait and watch to see how our advances growth really turns out to be.

Kaustav Bubna: But you are saying that you will have to wait and watch as for more expansion of liability branches, so what if in two quarters we continue with expansion of liability branches our opex will again spike. Also your NIMs are reducing because your NIMs will be lower because of reduction of your MFI portfolio. So, doesn't that all point towards low ROEs in FY18?

PN Vasudevan: See, on the branch and expansion, I think we have already mentioned our plans on that.

Kaustav Bubna: Simply put, what do you think, your cost to income was 63.4% in FY17, quarter one will be about 80%, then you are saying quarter two, quarter three and quarter four you are saying will peak around 80%. So shall I assume a higher cost to income in FY18, about 70% compared to 63.4% in FY17, I mean isn't that logical?

PN Vasudevan: I think that is quite logical.

Kaustav Bubna: And also your NIMs will reduce. So on your PCR you are going to do some higher year-on-year PCR next quarter, I mean your provisions will be higher on your next quarter, so on the PCR front what will it look like FY18 compared to FY17?

PN Vasudevan: So, I think there are lot of line items which are linked up to your ROAs and ROEs.

Kaustav Bubna: Coming down in FY18?

PN Vasudevan: Yes.

Kaustav Bubna: I am just trying to understand that you have come to a conclusion that in three to five years we are going to do 16% to 20% ROEs based on your cost of funds going down, eventually your liability branches being useful for you. So this is where most of your ROE expansion comes anyways in the three or five years. So, I mean, to build up to that I see a little fall in ROE before that actually happens and only with the success of your strategy will that ROE increase happen? That is another bet on your execution so, just to confirm, am I right that technically your ROEs should come down next year?

PN Vasudevan: Well, I think we will have to just wait and watch because ultimately it is all a bet on execution capability of the management team.

Kaustav Bubna: Yes, but that execution will be tested up to one year?

PN Vasudevan: Correct. Yes, absolutely execution will be tested up to one year, we will know how well we have been able to execute. And of course, I cannot say anything now which could give assurance to you or to anybody else as to how well we will execute into the future. But all you have to do is go back and watch our past and see whether we have been able to execute what we set out to do as well as we have been predicting our execution capabilities. So I think you will have to just go back to the past to extrapolate the capability of the management to execute in to the future. Beyond that I can really offer very little assurance or confirmation on execution capability into the future. So I think you will have to just come back to us maybe a year from today.

Kaustav Bubna: I will probably take this offline with you, I will probably meet you in the next one or two months.

PN Vasudevan: Yes, absolutely. We can always do that, but at the end of the day there is very little I can tell you in terms of our ability to execute tomorrow morning. All I can tell you is how well we have executed till last night. If you want me to list out a set of things that we have actually executed, so far: We are the only MFI in the country who have actually gone and been able to create a well-diversified book starting from 2011 onwards. Now if you go back before 2011, we were the only MFI who started at a lending rate of 25.5% whereas the market rate was quite above that. Our operating cost of Micro Finance in March 2010 was 7.6% at a time when peers were double of that. We were the first to convert our NBFC into a bank in all of about 11 months from the time we got our first license to convert into a bank and we have also set up a good number of liability branches within a short space of time. I think we have done reasonably well on past levels of execution, but beyond that there is nothing else I can say in terms of future execution. We will be happy to meet whenever you want.

Moderator: Thank you. We have the next question from the line of Vishal Rampuria from HDFC Securities. Please go ahead.

Vishal Rampuria: Sir, basically if I look at your slide I see that number of customers who are defaulting is increasing from last two, three months. Can you explain why it is like this?

HKN Raghavan: If you look at the number of clients, it is not that the complete default has come to a standstill; it is not that the gates are closed and the clients are not repaying at all, it is not like that. What is happening is that the number of clients who are reversing, going back, rolling back into one installment, two installments and regularizing is also happening. Let us say, as of March 31st, we have 35,000 clients who out of 1.9 lakh clients who have come and paid one or two and then they have started paying regularly. In the same period, because of the disturbance which is still continuing, fresh set of customers are also defaulting. So, net-net the incremental increase of number of clients has slowed down, but it has not stopped, it is also same for the industry.

Vishal Rampuria: But Sir, if you get your number of delinquent customers and this was around 1.5 lakhs as on December which has increased to 2.1 lakhs as on March. So, isn't that at a net level, we should have less number of customers who are defaulting?

HKN Raghavan: No, the total number of clients who have defaulted is 2.1 lakhs. Amongst this, there are close to 35,000 clients who have also paid one or two installments and got regularized. But they are not out of their entire delinquency… from the three installments they would have paid one and got regularized. So that is the reason you will find this number.

Vishal Rampuria: So you are saying that they have not cleared entire over dues?

HKN Raghavan: Correct.

Vishal Rampuria: Sir, second question I have is, can you help me out with the yield on your different segments?

HKN Raghavan: Segment level yields are not there now, I do not think we will be able to give. It is at a consolidated level.

Vishal Rampuria: And Sir, one last question to ask you, you mentioned on the call that you expect the cost of borrowing to come down because of repricing of CPs and NCDs. Can you help me out how much you think the cost of borrowing should come down for FY18?

TS Narayan: Well, the substitution of some of the borrowings which are there has been at very high levels. So you can safely assume the cost of borrowings should come down by close to about 0.75% to 1% surely.

Vishal Rampuria: So, in the fourth quarter it was 9.7%, so can I assume that it will go below 9%?

TS Narayan: Yes, it should come close to 9% or slightly below that.

Vishal Rampuria: One more question to ask you. If you look at your gross NPA at the level of used CV and your LAP, it is on the higher side, but on the micro LAP it is only 0.2%. Can you explain what is different that you are doing in case of micro-LAP compared to your LAP?

HKN Raghavan: See, as I had actually outlined, the micro-LAP clients, it is a cross sell product for the existing clients. So if you look at it we have been eight to nine years in the industry and we have a lot of relationship with our clients over period of so many years. So, in terms of understanding, analyzing and assessing the client, we are in a far better position to assess the client. Also you have the same channel people who are doing Micro Finance collections are also having relationships with them. So hence the recovery is far better. So that is one of the major reasons why the recoveries are so good. The NPA levels are completely under control. And in terms of these assets, they are all assessment clients. Hence you need to have developed the ability to do an assessment of the informal income which peaks over a period of time, on the ground level the credit as well as branch has kind of mastered it over a period of time. So the success rate seems to be pretty good as of now.

Moderator: Thank you very much. Due to time constraints, that would be the last question. I would now like to hand the conference back to Mr PN Vasudevan for closing comments.

PN Vasudevan: Thanks all of you for being on the call. We did try our best this time to give as much information as possible, keeping a lot of factors in mind on the various financials and also the new products, the liability branch rollouts, the CASA percentages as well as the detailed analysis of the Micro Finance issue that has been grappling the industry for the last three, four months. I hope you found it useful and we will try to continue to try and give as much information as possible to make it really useful and relevant for you as to how we are performing and what we are doing. Few minor things like our ability to execute into the future which you will have to take it at face value, the rest we will try to give as much data and information as possible. Thank you so much for being on the call and wish you all the very best. Thank you.

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