# "IndoStar Capital Finance Limited Q2 FY2019 Earnings Conference Call"

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**Moderator:** Ladies and gentlemen, good day and welcome to the IndoStar Capital Finance Q2 FY2019 Earnings Conference Call, hosted by Motilal Oswal Securities Limited. 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 telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Piran Engineer from Motilal Oswal Securities. Thank you and over to you Sir!

**Piran Engineer:** Thank You. I welcome you all to the concall of IndoStar for the 2Q FY2019 Earnings Results. We have with us Mr. R. Sridhar, Executive Vice Chairman and CEO, Mr. Pankaj Thapar, CFO, Mr. Shailesh Shirali, Head of Corporate Lending and Mr. Prashant Joshi, Chief Operating and Risk Officer. I would now like to hand it over to the management for the comments. Over to you Sir!

**R. Sridhar:** Thanks Piran. Thank you for joining our briefing of Q2 FY2019 results. As Piran mentioned that we have had a very strong quarter. I will now take this opportunity to give you a few highlights. The profit after tax for this quarter is 103% up compared to the last quarter at 64 Crores. It is on account of strong disbursement, which is at Rs.1302 Crores, which pushed our assets under management as on September 30, 2018 to Rs.7766 Crores, which is 76% higher year-on-year and as usual our asset quality continues to be very good. Our gross nonperforming asset is at 0.9% and net at 0.6% as on September 30, 2018. The retail disbursements are progressing very well in all three verticals, vehicle finance, SME as well as our home loans. This quarter our average disbursement run-rate is Rs.300 Crores and the total disbursement is around Rs.889 Crores, which is 58% higher over March-18 quarter.

The proportion between corporate lending and the retail loans continuously keeps changing. It started off this year with the retail loans at 27%, and as on September 30, 2018 it has moved to 37%; Corporate lending share of total loans is 63% for the current quarter. The branch network (in the first phase) comprises 155 branches in almost 17 states. Most of the branches distribute multiple product-lines. Of the total network, 136 branches are vehicle finance business and in 46 branches we offer affordable home finance and about 10 branches we have the SME business. We have also looked at the performance of these branches and about 75% of the branches, which have been opened in the first three months of December 2017, January 2018 and February 2018 have started contributing positively (covers direct costs) and with this kind of an encouraging result, we do feel that these branches will break-even as we have committed earlier within 12 to 15 months' time from their opening dates.

Cost to income ratio, which had gone up substantially because of our investments in infrastructure and people for conducting the retail business has started trending lower. During this quarter it has reduced by 650 basis points to 37.6%. The company continues to enjoy a comfortable capital adequacy at 31%, which puts our debt equity at 2:1 and at this point of time I am also happy to inform you that our liquidity management is quite strong. We have already put it in the public domain and submitted to the stock exchange our liquidity update as of September 30, 2018 and in all bucket's month-on-month from October 2018 to March 31, 2020 we remain positive and we have surplus also and the loan sanction pipeline was at Rs.650 Crores as of September 30, 2018 which has increased since then. We have started receiving some of these loans so we do hope that the liquidity position will ease and we would be able to keep our objective intact for this financial year, which we felt at an average of Rs.550-600 Crores per month we should be able to achieve Rs.6000 to Rs.7000 Crores as an annual disbursement. We have already disbursed around Rs.3500 in the first half, and are confident of achieving another Rs 3000-3500 crores in the next five months. So, with these words I now open the floor for questions.

**Moderator:** Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. Ladies and gentleman, we will wait for a moment while the question queue assembles. Thank you. The first question is from the line of Kashyap Jhaveri from Emkay Global. Please go ahead.

**Kashyap Jhaveri:** You mentioned about your target disbursement numbers about Rs.1000 Crores for this full year and current average stands at about 500 odd Crores per month this number for FY2020 and if you could break that up in terms of corporate and within corporate real estate and others and what could be the retail number?

**Pankaj Thapar:** It is inappropriate for us to talk about FY2020 because that would be significantly forward looking. If you are looking for what our current run rate is, we have explained that to you.

**Kashyap Jhaveri:** That is there in the presentation also actually.

**R. Sridhar:** We expect to continue seeing the trajectory of growth that we have charted out thus far. We expect to see the trajectory continuing. It would perhaps be inappropriate for us to put a number to where we expect FY2020 to be.

**Kashyap Jhaveri:** Sure and if you could go to slide number 18, which is on corporate lending the quarter-on-quarter corporate lending AUMs are down from about Rs.5250 Crores to Rs.4900 Crores and contributed by both the segment, which is real estate and non-real estate, so if you could throw some light on that decline in the AUM, what exactly was the reasons behind that?

**Shailesh Shirali:** This is Shailesh here. The reason for the decline in AUM was a couple of prepayments both in real estate and non-real estate segments which were ahead of schedule.

**Kashyap Jhaveri:** Any particular reason or this is just normal sort of, any particular reason why this happened or it is just the usual business that it just happened in this quarter?

**Shailesh Shirali** If you see our track record in corporate lending we have always had large prepayments. In the real estate lending segment, we enter into projects early, and most of the times we conceptualize the project along with the developer. As the project milestones reach 20-30% completion, these projects tend to get refinanced either by banks or players like HDFC in the normal course. On the non-real estate side, this time around, we had a couple of structured loans, where larger amounts were repaid. We always have an escrow mechanism for all our loans and this time around, we had monthly repayments which was faster than our expectations. We have had higher prepayments in the past as well and if you see in the last couple of years the repayments and prepayments have been pretty high.

**Kashyap Jhaveri:** And in this real estate business, now that we have been hearing from lot of NBFCs as well as banks people are sort of pulling back the purse strings through real estate developers what is your assessment of the overall real estate financing for next about let us say quarter or two and do you believe that if let us say this kind of scenario continues then we might eventually see an impact both on the real estate, asset quality of the developers as well as contagion impact on the real estate prices also?

**R. Sridhar** Let me answer this in two parts, the first part is our real estate book is about 20, may be 25% thereabouts of the total book. Within corporate lending we have real estate and non-real estate. The total balance sheet size is about Rs.9000 Crores and the real estate book is just Rs.2500 Crores. Within this segment, in the last three or four years we have been focusing on larger developers in Mumbai. That is because, we consciously took a call about three to four years back that the other locations, the other metros were slowing down, so we started focusing only on larger developers in Mumbai, who have residential projects in Mira road, Borivali, Kandivali, Thane or Kalyan. We have stayed away from the luxury segments; we focus on apartment ticket size between Rs.60 lakhs and Rs.2-3 Crores, which today people call affordable housing segment, but that is what we have always been doing because the cash flows are much faster here and also backed by project completion. So, we have been doing that for the last more than five, six years and we will continue to do that. We have never done anything in the luxury segment. The pain that you have been seeing have been in the smaller developers across India that is because of the consolidation that has started happening two to three years back and which was kind of accelerated after demonetisation, RERA and GST and there has been consolidation towards larger developers, which we feel will continue over a period of time. The smaller guys will get phased out of the market that is one, and the other pain factor was in the luxury segment, which as I said we have not done, we do not do projects where apartment ticket size is above Rs.4-5 Crores, so because of that we have not been impacted much because of the pain in the real estate segment. That being said if we are talking about the overall market yes definitely there has been a slow-down in the overall market and the cash flows have slowed down, but the kind of developers that we are working with, the size of the developers, the spends in those micro markets that we are doing we have not experienced much slow down there, so we kind of picked and chose what kind of developers we want to work with and what kind of projects and that you can see in the portfolio how the repayments and prepayments happened over a period of time.

**Kashyap Jhaveri:** And generally as a market, is my understanding correct that the belief is that for fair part of the market, which may be the organized players as well as the larger ones, the funding should not be an issue after this liquidity the whole crunch is over?

**Shailesh Shirali** I do not think so, in fact like there has been consolidation in real estate space and projects have moved more towards the larger developers, there will also be a flight-to-quality from the lender side and the larger developers I do not think over a period of time they will find it difficult to get debt or equity for their projects.

**Kashyap Jhaveri:** Thank you very much Sir. Thank you.

**Moderator**: Thank you. The next question is from the line of Siddharth Raj Purohit from JHP Securities. Please go ahead.

**Siddharth Raj Purohit:** Sir in the SME segment we have seen that government through some online means is pulling SME segments in the finance, so our ticket size is also close to Rs.1 Crore and up to Rs.1 Crore they are giving collateral free loan, so do we see this competition increases?

**Prashant Joshi** This segment actually has been in the past collateral free loans up to Rs.1 Crore, which has been dominated by banks and while these were collateral free loans clearly most of the banks use the guarantee mechanism of SEBI to lend against that. There are two things, which have happened, one is now NBFCs also have that guarantee mechanism so if you want we can access through that route as well and the second as all of you know not all the banks are in a great place as far as incremental lending is concerned, so in that sense it is not really a threat that would affect the volumes that we would be able to generate through our own SME business.

**Siddharth Raj Purohit:** In SME our average tenure is 15 years, can you just explain what kind of loan because 15 years seems high?

**Prashant Joshi** The 15 years is a contractual tenure in however what we have experienced, we have been doing this business now for three-and-a-half years and in general we have seen that every year we get prepaid to the extent of about one fifth of our opening portfolio for that year and that is the experience that we have had, so really speaking behavioural maturity of this loan is more like four to five years, so while the contractual maturity is indeed in between 12 to 15 years, but the behavioural maturity is more four to five years.

**Siddharth Raj Purohit:** Fine Sir. Thank you. All the best.

**Moderator**: Thank you. The next question is from the line of Rachit Agarwal, an Individual Investor. Please go ahead.

**Rachit Agarwal:** First of all congratulations on good set of results. There are some discussions on the corporate real estate exposure although I understand that it is a small part of the book, but given the ticket sizes are larger in the segment just a couple of more special questions on it, if you may allow me. Sir you said most of the exposure is to the larger developers in Mumbai, I understand there was one exposure to a real estate development firm and that real estate development firm has been under pressure for some time, so just wanted to understand that exposure is doing fine or if there have been any delays on that exposure?

**Shailesh Shirali** No, it is doing okay, we have started with a higher exposure three to four years back, it is now down to about Rs.50-55 Crores now.

**Rachit Agarwal:** Thanks a lot and any of the NPAs on our books part of the real estate portfolio?

**Shailesh Shirali** No, we have only one NPA in our books, this was a paper company when we gave the loan it was Rs.90 Crores peak exposure when it turn NPA the exposure was Rs.65 Crores. We have recovered most of it. We are down to about Rs.19-20 Crores now.

**Rachit Agarwal:** Great sir. That is very heartening. Thanks a lot for answering the questions.

**Moderator**: Thank you. The next question is from the line of Mamtesh Sugla from New Quest Capital. Please go ahead.

**Mamtesh Sugla:** Thank you for the opportunity, just wanted to clarify for corporate lending segment, how many number of borrowers do we have and what is the average ticket size?

**Shailesh Shirali** Last quarter was about Rs.150 to Rs.200 Crores ticket size that is because we focus on larger borrowers and we typically have about 50 to 60 borrowers on our books at a time.

**Mamtesh Sugla:** Thanks and will it be possible for you to comment on the top five exposures and if we have experienced any delays in payments over the last 30 days or if we are aware of these large accounts defaulting with other banks given there has been some press around Mumbai based developers defaulting with other NBFCs?

**Shailesh Shirali** So the larger exposures we have our developers like Kalpataru, Kanakia, Puranik, there is JP infra in Mumbai, so these are the larger developers. In non-real estate there is Venkateshwara Hatcheries and none of them have delayed payments to any of their lenders.

**Mamtesh Sugla:** Thank you.

**Moderator**: Thank you. The next question is from the line of Umang Shah from HSBC. Please go ahead.

**Umang Shah:** Sorry I joined the call late so I might have missed the initial comments on liquidity. I see your borrowing mix is fairly diversified, but if you could just throw some light in last one month what sort of borrowings you have been able to do from the money markets and from banks and what is the differential in terms of the marginal cost of borrowing?

**R. Sridhar** We have not borrowed any money during the last 30 days because we are comfortable with our liquidity position. If you had looked at our liquidity update, which we have filed as of September 30, 2018 you will find that our 18 months starting from October-18 to March 2020, month-over-month in all buckets we have been positive and we have an excess of around Rs.800 Crores. Apart from that, we have about Rs.650 Crores of sanctioned limits, which the banks have told us that they will start lending from November 1, 2018, so as told today we have already received around Rs.150 Crores, we are likely to receive on a daily basis this money and then we have newer proposals also, which got sanctioned, some mutual fund money is coming, some securitization is going through, so from all sources I think we should be in a comfortable position with regard to cash, so our ALM is intact, our debt equity is only 2:1 and our asset quality is fantastic, money flow from new sanctions are coming, so we are confident that we should be able to go through with our original plan of lending, which is Rs.500 to Rs.600 Crores per month quite easily that is our belief as of now.

**Umang Shah:** So fair to say that for you things have pretty much normalized or probably by the end of this month it would be pretty much business as usual for you guys?

**R. Sridhar** Correct.

**Umang Shah:** So Mr. Sridhar while I have you on the line, on vehicle finance business also if you could just throw some light so clearly there have been some mixed kind of reviews about the demand at the beginning of the festive season and stuff like that obviously there have been increasing costs on the insurance side, fuel costs have been rising so what is your outlook on the vehicle finance business not from immediate one or two quarter perspective, but clearly from next one to two years perspective and how do you see IndoStar's book shaping up?

**R. Sridhar** Our presence is 70% in used vehicles and 30% in new and we are catering to a segment of customers, who are two or three vehicle owners. In this segment, we have a few companies, which are competing with us, but we have created 136 branches and 1060 people network who have had experience of 5 to 20 years in the same business so we had a good start from December 2017. We have done in the first 10 months around Rs.750 Crores of lending, which at the last month current run rate we will see that we have done around Rs.130 Crores, which is about Rs.1 Crore per month per branch and we have also looked at the contribution from branches. The branches, which we have opened first three months, December, January, February, 75% of the branches, have already started making positive contribution, so we do feel that in 12 to 15 months run up each branch will break even as we have committed earlier. The demand for commercial vehicle continues to be good except only one dampening factor is the fuel prices. Normally when the fuel prices go up the freight rates also get adjusted, but there is always a lag effect, so now the fuel prices have gone up substantially the truck operators, the main truck operators will be discussing negotiating the rates and the freight rates will follow, you know it will go up, in the meantime the operating cost will take a hit and because of that the truck sales may little bit dampen, but as far as we are concerned since we are predominantly present in used vehicles we are not hit by the new vehicle sale, in the new vehicle market our presence is only 30% and in terms of quantum it is only 30 to 40 Crores per month, so that is not a big deal compared to the large people who are present in that market. As we have started new and our disbursements per month is Rs.125 to Rs.150 Crores we may not be impacted in a big way even if there is a small slow down because of the fuel price increase.

**Umang Shah:** Right, that is helpful and on the corporate side I do see that this quarter we had roughly about Rs.700, Rs.800 Crores of repayments this appears to be slightly higher than the usual run rate or is it just the disbursements have been lower this quarter and hence the impact on AUM is looking higher?

**Shailesh Shirali** This quarter the prepayments were a little higher because couple of real estate projects got refinanced by banks so they all came in at the same time, otherwise we do not see such high prepayments in one quarter.

**Umang Shah:** Got that and on the home loan business let us say before this whole liquidity incident happened there was a competition between banks, HFCs and NBFCs and clearly for relatively smaller players like us, the differential in the cost of funds, so there was ex-differential now post the crisis clearly that differential rises and advantage further shifts in favour of banks and larger HFCs, in view of that what would be our strategy to kind of scale up the home loan business?

**R. Sridhar** Our presence is going to be only in affordable home finance. We have been lending at around 12.5% to 13% and our segment is self assessed income category and self-employed people. Our disbursement is Rs.40 to Rs.50 Crores per month, so that even if the cost of funds go up we will increase the rate and there is no problem in this segment of customers unlike the salaried segment of customers where there is huge competition from banks, so I do not think this will have any impact even if the cost of funds go up 50 to 75 basis points in the future.

**Umang Shah:** Thank you so much and wish you all the best. If I have more questions I will come in the queue.

**Moderator**: Thank you. The next question is from the line of Dhruv Sapra, an Individual Investor. Please go ahead.

**Dhruv Sapra:** Thank you for the opportunity. Sir what would be our incremental cost of funds for this quarter?

**Pankaj Thapar** As we mentioned during October we have not so far taken any disbursements; however, the cost of money that we are getting medium term money, which is our preferred mode of financing we would expect it to be somewhere between 50 to 100 basis points higher than what we have borrowed in the previous quarter. The exact impact will be a function of what quantum of money we draw because we have about Rs.5600 Crores of debt currently outstanding, so assuming at our Rs.1000 Crores at 100 basis points more the impact of that will only be about 15 basis points.

**Dhruv Sapra:** Secondly sir, in the current scenario is it easy to pass on the incremental cost of funds to the customers and what the current situation would be?

**R. Sridhar** It is possible because we are in two high yielding segments viz. corporate lending business and vehicle financing. In the corporate lending segment, we can pass on cost increases, but the vehicle finance is only the fixed lending, so we will not be able to reprice the earlier loans, but for new loans, we will be able to increase rates. SME and home loans are offered on floating rates and repricing is relatively easier.

**Dhruv Sapra:** Thank You so much Sir.

**Moderator**: Thank you. The next question is from the line of Sagar Karkhanis, an Individual Investor. Please go ahead.

**Sagar Karkhanis:** Thanks a lot for the opportunity. Can you just let us know how many more branches are we planning to open this year and what would be the target the cost of income ratio or the impact on the cost of income ratio we are expecting?

**R. Sridhar** In our first phase, we opened around 125 to 130 which was there in our original plans and we have also planned to have coexisting branches because there are three lines of business we do in retail, SME, housing finance and vehicle financing. ,We have opened around 136 branches so far in phase 1 and these branches we have seen the performance and we have worked out the contribution and as I mentioned earlier in the first three months we have opened around 40-50 branches, 75% of those branches have already started making positive contribution, so as mentioned earlier and also during our road show we would like first to breakeven these branches and then only look at second phase of branches, so till these branches breakeven, which we estimate from the current performance it will take about 12 to 15 months so after that we will look at opening the second phase of branches till then we will not get into any new branch opening and the cost to income ratio, which went up because of setting up this kind of an infrastructure and people, it has come down by 650 basis points during this quarter to around 37% so earlier it was 44% now it has come to 37%, so it is trending lower so if we do not open new branches and recruit more people it will trend down in every quarter.

**Sagar Karkhanis:** We had guided for Rs.12000 Crore of loan book by end of FY2019 do we still hold that guidance?

**R. Sridhar** As per our disbursement ability and the potential of the verticals, the business lines we have I am very confident, but today it is subject to liquidity and in that also I am very confident that it will be possible, but at this point of time it is difficult to commit. It would be better if we wait for another one month and look at how the liquidity position changes in the market place. We are getting positive feedback from the banks and mutual funds and other institutions. In October week-on-week liquidity has improved and I am hopeful that things will drastically change and we should be able to go as per our original plan.

**Sagar Karkhanis:** Any exposure to IL&FS or any of the SPVs?

**Pankaj Thapar** No, no, not at all, not even in the debt funds in which we hold our liquid surpluses.

**Sagar Karkhanis:** Thanks a lot Sir.

**Moderator**: Thank you. The next question is from the line of Mamtesh Sugla from New Quest Capital. Please go ahead.

**Mamtesh Sugla:** Thanks again for the opportunity. Just wanted to clarify on vehicle finance and thank you for providing details of each business lines, which is really helpful. You have mentioned the phase 1 of expansion is over, can you elaborate on the phase 2, how many branches are we looking, I understand it will be 12 to 18 months later and second question related to this as what do we expect the stable state cost to income ratio in the segment to be?

**R. Sridhar** We are not planning to open any branch now, unless and until all these phase 1 branches breakeven, which would be middle of next year or Q1 of next year so after that only we will plan. The number of branch additions is in our hand so we will decide, but as of now we do not have any number in mind. The cost to income ratio, which we started up with 40 plus has now come below 40 and we are at 37%, so it should trend lower if we do not start incurring anymore branch expenses, so if we take this as a batch we should move down, over a period of time in two- or three-years' time I think we should be around between 25% and 30%.

**Mamtesh Sugla:** This is for the overall business?

**R. Sridhar** Overall company.

**Mamtesh Sugla:** Thank you so much for answering my question.

**Moderator**: Thank you. The next question is from the line of Rachit Agarwal, an Individual Investor. Please go ahead.

**Rachit Agarwal:** Sir this is regarding the new products, are we looking at launching new products say in 12 months time or after that?

**R. Sridhar** No, as of now whatever we have launched like vehicle, SME, home loans in that affordable only and corporate lending that is enough. We have so many products on hand and that depends on the potential also, so if you read the CRISIL reports they clearly say these are all the four lines of business, which will have extraordinary potential for growth. We have been fortunate to go into those four lines so we would like to stick to that and then as philosophically we have been lending only to secured with collateral, we have not done any unsecured lending and also we have not done any loans for consumption, so we would like to stick to that kind of philosophy in choosing lines of business.

**Rachit Agarwal:** Thanks a lot.

**Moderator**: Thank you. The next question is from the line of Naitik Mody from OHM portfolio. Please go ahead.

**Naitik Mody:** Thank you for the opportunity. Sir in terms of the branches could you give us a sense of what could be the business generated by each branches at peak levels may be in a couple of years' time?

**R. Sridhar** It depends on the number of people we give, so it is own sourcing business in a vehicle finance. So it depends on the productivity initially it will be lower then it can grow faster so if you take a three-year loan on an average and we do around Rs.1 Crore, Rs.1.5 Crores per month, so we can go to a business of AUM of Rs.30 to Rs.40 Crores per branch.

**Naitik Mody:** In vehicle finance?

**R. Sridhar** In vehicle finance with good efficiency and asset quality and profitability, Rs.30 to Rs.40 Crores can be managed under one roof.

**Naitik Mody:** How about the other two businesses, SME and housing?

**R. Sridhar:** In terms of SME business we are already at almost in average of Rs.200 Crores per branch and there are larger branches, which are already housing about Rs.400 Crores of book, so I do not see a challenge in the same 10 locations where we are I think we can grow in a multifold in the same 10 branches at least for the next three years. As far as housing finance is concerned, pretty much like vehicle finance I think one crore per month would be the run rate at which we will be reasonably happy that the branch can then start breaking even and one branch can handle up to again Rs.30 to Rs.40 Crores pretty much similar to what vehicle finance has.

**Naitik Mody:** Thank you.

**Moderator:** Thank you. Ladies and gentlemen this is the last question for today. I now hand the conference over to the management for closing comments. Over to you Sir!

**Pankaj Thapar:** Thank you all for joining the conference. Just a couple of points to add to what has come up in the Q&A and what Mr. Sridhar mentioned in his initial commentary. This has been a strong quarter. We expect the trajectory to continue, but for obvious reasons we cannot offer any numeric guidance around that. From our perspective we had consciously taken the call with our philosophy to be conservative and not rush to the market to draw money because we had sufficient liquidity. As the market has cooled off a little bit we have started the draw down process in fact effective today as we mentioned during the call, which we expect to allow us to catch up for the brief fall that we had during October in terms of disbursement of loans and if this trajectory continues, which we believe should be the case, we expect to recover a little bit of fall that we had during the month. The other piece is as I am sure all of you would have picked up that the Board deliberated and adopted a dividend policy and we declared, after eight years of reinvesting all of our profits, a maiden dividend yesterday for which distribution will happen within November and then subject to the profit trajectory for the remaining half of the year we will look at obviously recommending to the board to consider a top up at the end of the year. Thank you for your participation everyone.

**Moderator:** Thank you very much Sir. Ladies and gentleman, on behalf of Motilal Oswal Securities that concludes this conference call. Thank you for joining us. You may now disconnect your lines.