"IndoStar Capital Finance Limited
FY 2018 Earnings Conference Call"

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Moderator: Good days, ladies and gentlemen and a very warm welcome to the Indostar Capital Finance Limited FY2018 Earnings Conference Call, hosted by Motilal Oswal Securities Limited. As a reminder, all participant lines will be in the listen-only mode. 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 "*" followed by "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Piran Engineer from Motilal Oswal Securities Limited. Thank you and over to you Sir!

Piran Engineer: Thanks Ali. Hi everyone. Welcome to the Indostar Capital Finance FY2018 concall. With us, we have the management Mr. R. Sridhar, Executive Vice Chairman and CEO, Mr. Pankaj Thapar, CFO and Mr. Shailesh Shirali, Head of Corporate Lending. I would now request management to take us through the financial highlights followed by Q&A. Over to you Sir!

R. Sridhar: The structure is going to be that we will give you a synopsis of our performance. Then we will get to questions and answers.

Pankaj Thapar: Good evening everyone. This is Pankaj Thapar. I am the CFO of the company. Just some headline numbers around our results for FY2018 that were uploaded on the stock exchange a few minutes ago and a presentation that perhaps should have been sent to you via Motilal Oswal, which you can also separately see on the stock exchange website. So just the big headlines. In terms of business you have to keep in mind the backdrop of the very significant investments that have been made by us in building up the retail business during FY 2018 where we invested almost INR 80 Crores in operating cost around the build out of our retail franchise across branches, people and associated infrastructure as well as a further approximately INR 20 Crores that we spent in capital expenditure for the branches and operation center and a business headquarters that we set up in Chennai for our vehicle finance business.

The big headlines with that small preamble, our disbursements for the year grew 10% year-on-year to about INR 5390 Crores ending the year with 19% growth in our assets to INR 6200 Crores. We had a profit after tax of INR 224 Crores up 6% versus the INR 210 Crores that we achieved last year, but as I said keeping in mind the very significant investments we made minus that this would have been a very healthy number that would be almost INR 50 Crores higher than what we have reported as the consolidated PAT.

Our ROA for the year was 3.5% and the ROE was 11.1%, but we had a very comfortable capital adequacy and a very comfortable leverage giving us very significant headroom for the growth that we are targeting and for which all of the infrastructure and all of the investment are pretty much in place to keep us poised for accomplishing that.

In terms of some of dimensions of our business, we ended the year with a corporate asset base of 74% of our loan book and retail businesses comprising SME, which for this year was the bulk of the retail business for which we can see the transformation in FY2019, Vehicle Finance, which as I mentioned is our big growth engine for FY2019 and housing finance in aggregate being 26% of the loan book.

We sharply expanded our branch presence and our employees to allow us to cater to all of the retail growth that we are targeting to achieve this year and there are more details around this by business segment in the presentation that we have shared with you, but we are today at 100 plus branches, 1000 plus employee in terms of our outreach to the retail customers in terms of our preparedness for the future. So with that, we will leave the forum for any questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Shyamal Lahon from Edelweiss. Please go ahead.

Shyamal Lahon: Thanks for taking my question. I am just looking at the yields and NIMs, there seems to be a little bit of a decline on a year-on-year basis? Just wanted to understand what guidance might be going forward?

R. Sridhar: Since there are multiple verticals, each vertical has got different spreads, so when we are looking at last year, where predominantly you had the corporate lending business and a little bit of SME, but this year we have had vehicle finance, which has similar yields like corporate lending, but you have the home loans, which are slightly lower, so that is why it has been trending down, so we should be focusing as a strategy. We are planning to focus on corporate lending business and vehicle finance, which should form part of 70% to 75% of our total assets going forward, where the yields are quite comfortable. Both these businesses will be operating at around 600 basis point spread, so the NIMs would be much higher than that, but when it comes to the other two businesses like home loans and SME, which are all at a lower interest rate and yields, these are going to be only 200-250 basis points, so I think on a weighted average basis if you put this on a NIM this should be around 6%.

Shyamal Lahon: Thank you.

Moderator: Thank you. The next question is from the line of Shreeram Viswamani from Myriad Asset Management. Please go ahead.

Shreeram Viswamani: A quick question. I have not been able to see the presentation yet, but if you can talk a little bit about what is the strategies of vehicle and the housing book? I know it should be a very small as of March 31, 2018, but what is the size today and if we look out let us say March 2019 and March 2020 where do you expect those loan book sizes to be?

R. Sridhar: The vehicle finance business is operating out of 100 plus locations in 15 states and its run rate today is around INR 75 Crores to INR 100 Crores per month and total assets of home loan and vehicle finance as of March 31, 2018 have been around INR 300 Crores.

Shreeram Viswamani: Both put together?

R. Sridhar: Yes both put together as of March 31, 2018, so this year it should be hitting a run rate of around INR 100 Crores plus on average for Vehicle Finance and another INR 50 Crores plus on an average for Home Loans and around INR 125 to INR 150 plus Crores on an average for SME business. These three constitute the retail loans, so the retail loans are going to be around INR 300 Crores to INR 350 Crores per month.

Shreeram Viswamani: Per month is it, okay. So sort of INR 3000 Crores sort of book in the sphere or little more, correct?

R. Sridhar: Correct.

Shreeram Viswamani: Fair and are these branches that you have opened for both these segments mostly South-based today as we speak?

R. Sridhar: No. We started off from Tamil Nadu, which happens to be vehicle ecosystem headquarters and our headquarters of vehicle finance is also strategically located there. Today our presence is in 15 states and these 100 branches are spread throughout these 15 states out of which the Tamil Nadu happens to be large, which is one third of the 100 is in Tamil Nadu. The balance two thirds is in the balance states, so going forward when we expand, it will happen in the other states, we will have more branches and in the Tamil Nadu it will be less.

Shreeram Viswamani: Am I right in understanding that vehicle finance book will all be internally sourced through the branches and for housing it will largely DSA or will that also be branch-linked?

R. Sridhar: In all businesses a mix is there. For example in the corporate lending business, it is completely internal sourcing. There is no DMA/DSA there. There is no broker involved. Similarly when you come to SME business, it is completely DMA/DSA sourced so, there is no internal sourcing, but the retail businesses of vehicle as well as home loans, it has a mix of both internal as well as DMA/DSA sourcing, which could be in the range of ratio of around 75% to 80% internal and maybe 15% to 20% in DMA/DSA. That is the kind of proportion we have.

Shreeram Viswamani: But that 75% to 80% internal will hold good for housing as well?

R. Sridhar: Yes.

Shreeram Viswamani: Interesting. Fair and what was the growth in the structure corporate finance loan book for FY2018? Again I have not seen the numbers, but at least some of your competitors have declared results so far seem to have had very, very strong growth in the segment and then we all seem to be saying that this is something that is likely to continue because the larger part of the financial system continues to be stressed?

Shailesh Shirali: We have been seeing consistently a growth of about 25% to 30% on both the real estate and the structured corporate lending space and yes we will continue to see the same kind of growth going forward. The traction is very good. Pipeline is very good.

Shreeram Viswamani: The 25% to 30% is your outlook for the next year right?

Shailesh Shirali: Right.

Shreeram Viswamani: What was the growth in FY2018 in both these books?

Shailesh Shirali: It was around 20% to 25% same.

Shreeram Viswamani: 20% to 25% right. Got it and just last question what is your view on funding cost from here on?

Pankaj Thapar: Clearly there is, at this point in time, upward pressure on pricing. That said, the one point I would like to state upfront is that as any prudent lender, we look to run our business on the basis of focusing on our margins and therefore try and ensure that there is a pass through. In terms of products all of our vehicle finance business while it is nominally fixed rate, the rate is effectively reset every period and given the growth, we would see the ability to reset pricing on a monthly basis for go-forward loan obviously not legacy loans. SME business is 100% on floating rate basis, so it is on a pure pass through. On corporate lending all of our lending on the structured corporate lending side is on floating rate basis. On the real estate segment, some of our legacy loans are fixed rate, but though at a pretty high coupons. On go-forward basis even those loans we are looking at pricing on a floating rate basis, so we would see the ability to maintain our margins despite the upward pressure on cost of money.

Shreeram Viswamani: Would it be fair to say that in terms of incremental margins, the higher margins of the vehicle finance business will be offset to an extent by lower margins on the above businesses leading to sort of stable margins over the next year or two?

Pankaj Thapar: That would obviously be a function of how the book shapes up. We see the vehicle finance business growing faster than we see the SME business or the housing finance business growing. Shailesh just mentioned significant growth also in the corporate book. On balance, we expect to see an improvement, but I think in terms of this call it may not be appropriate for me to venture on offering any views around that question beyond this. **Shreeram Viswamani:** Fair Sir, just one last question that I..only one more. Am I right in saying that you probably recruited a large part of your team for the newer segment by March 31, 2018 leading to probably higher opex growth in FY2018 and do you see the growth in opex coming off a bit in FY2019 or will it continued to be elevated?

R. Sridhar: If I can answer that question. We started building this middle of the last year and so the entire team had a very truncated financial year, so some of them were three months, some of them were two months, so all the team will have entire 12 months this year, so in terms of operating cost, the first full financial year for the team we have built for the 100 branches will come up in this year in FY2019 because all of them will be for 12 months, the entire 12 months will be there. In the last financial year, they have not been for the entire period.

Shreeram Viswamani: Fair point.

Shreeram Viswamani: You will full year cost on some of…?

R. Sridhar: Yes, opex will be more than last year because the entire team, which had been recruited in FY 2018 will have the full cost during this financial year.

Shreeram Viswamani: Fair point. Any ballpark estimate on what can be opex growth in FY 2019 and may be potential in FY 2020 as well?

R. Sridhar: FY 2020 I will not be able to say but this year, there will be a corresponding income also unlike last year. In the last year we have only incurred cost with very little income arising out of the operation, but this year the expense also will go up and income also will be there. So I think from this call point of view I do not think we can give you that number.

Shreeram Viswamani: No worries I can take that offline when I see you next. Fair point. Those are all the questions from my side. I look forward to see you all soon. Thank you.

Moderator: Thank you. The next question is from the line of Amit Kumar from Individual Investor. Please go ahead.

Amit Kumar: I just want to check on, this is a followup on the opex growth question, I understand that currently we have around 100 branches, so what is our plan for in FY2019, is there going to be a very steep increase in the number of branches or do you think, how many of the number of branches that we intend to add in the coming year and will that have a significant impact on the opex as well?

R. Sridhar: No. What we are strategically planning is to make first these 100 branches breakeven, so we are confident from the current traction, it takes about INR 10 Crores to INR 12 Crores assets under management for each branch to breakeven the cost, so from the current traction of business, which these branches are doing, we are confident that these branches will breakeven during this financial year. So we are going to look at few more branches only after breaking even these branches. So I do not think we will open more branches during this year. We will focus on breaking even these branches first and then look at further expansion.

Amit Kumar: Sir, just another question, not sure it has already been answered, since all the parts of the businesses are growing and growing fast from a little higher than others, how do you think we should look at the loan book in the next let us say two to three year, how will the shape look like, will it be largely dominated by vehicle finance or will corporate still be a larger portion, so how should we think about it in the next let us say two to three year given that we are focusing…?

R. Sridhar: Yes. These businesses are being driven by different business heads. We are growing in each vertical and we are not putting any number. We have been predominantly corporate lending business as at March 2018 you will find that 74% is corporate and 26% is retail, so this proportion will keep changing as and when the growth of retail businesses keep happening, but we are not putting any numbers to this. Each business head has been told to grow at a comfortable rate, which ensures profitability and asset quality. We are not going to chase volumes simply because we want to change the mixture between corporate and retail that is not going to be our approach, so vehicle finance have got high potential, corporate lending they are also high potential, so our intent is to grow these two businesses to the fullest potential and the two other businesses like SME and home loans will have a strategic leverage, is what we are planning. So over a period of next couple of years this proportion between corporate and retail will undergo a significant change. I am unable to put a number to this.

Amit Kumar: I understand, but directionally we are very much confident that it will start shifting towards retail?

R. Sridhar: Yes, it will keep changing. So we will see growth in the corporate book as well as in the retail business, but because the retail business is starting from a smaller base and it will be faster and overtime that mix will obviously change from there as a result of this process.

Amit Kumar: Sure, thanks for taking the question.

Moderator: Thank you. The next question is from the line of Suhani Doshi from Edelweiss. Please go ahead.

Suhani Doshi: Good evening Sir. Can you help me with the character of your corporate lending book, so what I wanted to know is, what would be the average tenure of your loan, ticket size of the loan and you mentioned earlier that your real estate and structured corporate lending has grown by 25% to 30% so as a proportion of your corporate lending book, how much would be structured corporate lending and real estate?

Shailesh Shirali: The structured corporate lending will be about 60% and real estate will be about 40%, it has been around that in the last couple of years and in real estate we do mostly residential projects in Mumbai, so the door-to-door tenure is about four years, but in reality the loan gets repaid within two to three years. These are all amortizing loans. There are no bullet loans and in structured corporate lending it is between three and five years, again these are amortizing loan. There are no bullet loans in our book.

Suhani Doshi: Sir, this residential project loan is the developer loans for residential projects?

Shailesh Shirali: Yes, that is right.

Suhani Doshi: Sir, you said what has grown by 20%, 25%?

Shailesh Shirali: I said the structured. The question was on the structured corporate lending that has book has grown by 20%, 25% and the developer finance book grew slower last year. This year onwards we see growth in both. Because last year there was demonetization and RERA and GST so we are little slow on the developer financing business, but now the traction is back, so we are growing both the businesses.

Suhani Doshi: What would be your ticket size in both of these categories?

Pankaj Thapar: 100 to 150 Crores average.

Suhani Doshi: Now with the retail book also going to grow significantly over the next two, three years, wanted to understand what kind of leverage, is the company comfortable with, I mean historically our leverage has been pretty low, so I wanted to see going ahead what leverage do we see?

R. Sridhar: Leverage is dependent on business as you rightly said, so each business will have different risk weight and different leverage, but what we are trying to do is to consume the capital in the next few years when we do that. The leverage will move to five to six times on an average.

Suhani Doshi: Currently, it would be around 3 times I guess and that you are saying 5 to 6 times over the next few years?

R. Sridhar: Yes, because the home loan is very less risk weight, so on an average it will move to five to six times.

Suhani Doshi: That is it from my side. Thank you.

Pankaj Thapar: Just one supplement to that answer is the fact that all of our Tier 1 capital except a small portion of Tier 2, which arises from our provision for standard assets, which are classified as Tier 2. At this stage we have not used a Tier 2 strategy or off balance sheet or securitization strategy. For these elements, at the appropriate stage, we will roll them out and use in our business.

Moderator: Thank you. The next question is from the line of Anirudh Singh from Individual Investor. Please go ahead.

Anirudh Singh: Thank you for the opportunity. I have a question regarding your NPA. So I see that your NPAs at around 1.3% if you could help with some colour on that segmented wise breakup regarding NPA that would be NPAs for each of the business segment that is my first question and the second question is on the competition, what kind of competition are you facing from some of the competitors like Piramal or Aditya Birla which you can throw some colour on that? That would be helpful.

R. Sridhar: First on the NPA, as you rightly said it is NPL is 1.3%, but most of these NPAs is being out of the SME business where we have got self-occupied residential property as a collateral. In the corporate lending business we have only one NPL account, which also we are confident that we will resolve without any loss in that, but in the SME business for us it takes a little bit of time to liquidate the self-occupied residential property because as a company we are still to enforce the SARFAESI, so it takes a little bit of a time that is why the NPL has moved up, but we are very confident that during the current year we should be able to bring this under control. Shailesh will answer your second question on the competition in Corporate Lending.

Shailesh Shirali: In the Corporate Lending side, in the structured lending we have companies like Edelweiss, L&T and in the real estate space we have Piramal, PNB Housing, again L&T, so for each is different competitions.

Anirudh Singh: And more thing is that what part of your SME book is on self-occupied property?

Pankaj Thapar: Sorry, could you repeat the question it is not clear?

Anirudh Singh: I was asking what percentage of your SME book would be on the self-occupied residential property?

R. Sridhar: Majority of SME book 90% plus is against self-occupied residential property.

Anirudh Singh: 90% against self-occupied residential property?

R. Sridhar: Yes.

Anirudh Singh: Thank you Sir.

Moderator: Thank you. As there are no further questions, I now hand the conference over to Mr. Piran Engineer for closing comments.

Piran Engineer: Thank you. We thank the management for giving us this opportunity to host the concall and all others for joining in on the call. Thanks and good-bye.

Pankaj Thapar: Thank you.

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