INDOSTAR

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BSE Limited
Listing Department, 1st Floor,
P J Towers, Dalal Street, Fort,
Mumbai - 400 001

Scrip Code: 541336

National Stock Exchange of India Limited
Exchange Plaza, C-1, Block G,
Bandra Kurla Complex,
Bandra (E), Mumbai – 400 051

Symbol: INDOSTAR

Sub.: Transcript of analyst(s) / institutional investor(s) call held on Friday, 13 August 2021 at 9:00 a.m. (IST)

Dear Sir / Madam,

Please find enclosed herewith transcript of analyst(s) / institutional investor(s) call held on Friday, 13 August 2021 at 9:00 a.m. IST, pertaining to the Unaudited Financial Results of the Company for the quarter ended 30 June 2021.

The transcript is also available on the website of the Company at www.indostarcapital.com.

Request you to kindly take the above on record and disseminate the same on your website.

Thanking you,

Yours faithfully,

For **IndoStar Capital Finance Limited**

Jitendra Bhati
SVP – Compliance & Secretarial
(Membership No. F8937)

IndoStar Capital Finance Limited

Encl: a/a

"IndoStar Capital Finance Limited Q1 FY-22 Results Conference Call"

August 13, 2021

MANAGEMENT:MR. R. SRIDHAR – EXECUTIVE VICE CHAIRMAN & CEO, INDOSTAR CAPITAL FINANCE LIMITED

MR. AMOL JOSHI – CFO, INDOSTAR CAPITAL FINANCE LIMITED

MR. DEEP JAGGI – CHIEF BUSINESS OFFICER, INDOSTAR CAPITAL FINANCE LIMITED

MS. JAYA JANARDANAN – CHIEF OPERATING OFFICER, INDOSTAR CAPITAL FINANCE LIMITED

MR. SALIL BAWA – HEAD INVESTOR RELATIONS, INDOSTAR CAPITAL FINANCE LIMITED

MODERATORS: MR. ALPESH MEHTA – MOTILAL OSWAL FINANCIAL SERVICES

Moderator: Good morning ladies and gentlemen, welcome to the IndoStar Capital Finance Q1 FY22 Results Conference Call hosted by Motilal Oswal Financial Services 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Alpesh Mehta from Motilal Oswal Financial Services. Thank you and over to you sir.

Alpesh Mehta: Thanks a lot Louisiana and good morning everyone and welcome to IndoStar Capital Financial Results conference call to discuss about Q1 FY22 earnings. Today we have Mr. R. Sridhar; who is the Executive Vice Chairman and CEO, Mr. Amol Joshi; CFO, Mr. Deep Jaggi; Chief Business Officer, Ms. Jaya Janardanan; Chief Operating Officer and Mr. Salil Bawa; who is the Head Investor Relation. Now without much ado I hand it over to Mr. Sridhar for the opening comments and post which we will have a Q&A session. Thanks, and over to you sir.

R. Sridhar: Thank you Alpesh. Thanks for all the participants for taking time out to join this Q1 FY22 earnings call. Hope all of you and family are staying safe and healthy.

Before we discuss the Q1 numbers I would like to set the context for our interaction today morning. As you all know IndoStar is managing a transition for the past few years, moving from corporate lending business to granular retail business. When I joined in 2017, we had an 80-20 mix of corporate and retail which we have in the last 4 years successfully converted into a 20-80 almost. So, in the last 2 or 3 years when the entire industry faced multiple challenges commencing from the credibility and liquidity crisis arising out of IL&FS, followed by sluggish GDP, see the down cycle and on top of it along 15-16 months of pandemic COVID-19 wave 1 and COVID-19 wave 2. During this challenging period, we have achieved few strategic initiatives which has put IndoStar on a strong wicket for a future growth.

The first good thing which we have done during this period is strengthening of the balance sheet. In that respect we have been able to bring a global, strong private equity Brookfield which is the second largest in the world. Brookfield had multiple options to invest in the NBFC space as we had multiple partners who were looking for capital. But finally, the chemistry worked out and Brookfield have taken equity in the company and now become a significant single largest shareholder with the majority stake. This partnership has not only provided growth capital but also strengthened our ALM and as Brookfield had lot of relationship with the banking community, it has also improved our liquidity pipeline substantially. At one stroke we have strengthened the liability substantially because of the huge growth capital had come and also looking into the impact of the challenges which we were facing in enrolment those have mandated the company and the management to clean the books. We have taken accelerated provisions, aggressive write-off and a couple of AIP transactions we have done in the last 2 years, particularly in March '20 and in March '21. With that by Q1 of June 30th, I feel that we have completely cleaned the book. I do feel that there will be no further credit cost which will come on a portfolio which is up to 31st of October, 2020. These two have been major decisions which we have taken to strengthen the liability side. The third major decision we've taken is a partnership with ICICI Bank. As we have encountered a massive liquidity crunch in the marketplace as a strategy, we have built a partnership with ICICI Bank where we have already lent more than 1000 crores in CV business on a franchisee model, a co-lending model. We have renegotiated the commercial and that partnership is going to make us leverage more going forward as well as it will provide the much-needed liquidity in case the liquidity crunch comes back in our 5-year journey. With this kind of initiatives, we have done we have also prepared the aspirational 5-year plan commencing from 1st April, 2021 to 31st March, 2026 where we have articulated clearly our granular retail journey. So, in that what we have done in the 5-year plan is clearly we have spelt out that we will exit the corporate lending business. We are now 77% retail and 23% corporate which I hope that by March, 2022 will come down below 10%. In next 1 year this will eventually become zero, leading to the IndoStar becoming a full 100% retail financing company.

In the retail financing space, we are strategically going to use three balance sheets. The parent balance sheet is going to be fully 100% used vehicle which will comprise of mainly used commercial making financing business. In this used commercial vehicle financing business, which we have been doing we are going to expand geography, product as well as customer segment. As you all know there are two major companies in this business which is Shriram Transport and Chola. We have carved this for ourselves in the customer segment which is beyond first-time users. As Shriram Transport is the leader in first-time user segment, we are not going to be present there. It's a very difficult business. We are going to be from first time borrowers to 5-year vehicles loan as against the earlier customer segment of two or three vehicles. This expands our customer base for future growth potential. As we are presenting 250 locations, we have an aspiration to build 1000 branches which would be built on a hub-and-spoke model with the smart branches. The hub-and-spoke is for every hub there will be three branches and one rural center consisting of five business locations contributing to about INR 6 crores per month disbursements. Today we have 250 of the key hubs which will contribute about INR 300 crores per month, from there we are moving to 200 hubs in the next 5 years. That is the geographical expansion which will consist of all the four zones, East-West-North and South as well as we have already started our presence in the Northeast. So that is one.

The third is the product expansion; apart from used commercial vehicles, we will also be creating presence in tractors, passenger commercial vehicles and construction equipment. We do hope that our projections show this will not go beyond 5% each, contributing to 15% in total, the balance 85% will be in used commercial vehicle. We are going to focus on 5 to 12 years segment where the penetration of the current players is less than 50%, leaving a lot of scope for us to gain market share.

As you all know the scrappage policy is on the implementation phase, once the pandemic subsided this is going to come and we estimate that 78 lakh vehicles which are beyond 15 years will be phased out gradually and this will generate a huge replacement demand of INR 100,000 to INR 125,000 crores. So, sensing this kind of an opportunity, we have strengthened our senior management team by bringing in a Chief Business Officer who has put in 20 years in this space, Deep Jaggi and recently we have brought Mr. Ravi Kumar, another 20-year veteran from Chola, both of them have top minded. They have been followed by lot of regional, divisional and SBU-2. So, we have a fantastic team in place. The proof of the pudding is in the business which we have done from November, 2020. After the pandemic moratorium and restructuring the portfolio, we have generated in the last 9 months from November to July of INR 1250 crores, more than 95% of them in Stage 1 which proves that the work we have done, the learnings we are made of the past and changes we have made in the team as well as in the policy is proving to be fantastic. So, from the current INR 3000 crores we feel that in the next 5 years this used commercial vehicle finance business will grow at least 10X in the next 5 years. That is the kind of potential is there and we are well prepared to take that advantage.

As far as the second balance sheet is concerned, it's going to be about housing finance business where we have focused on AIHS. I am happy to inform you that we have crossed INR 1000 crores AUM in this business. In the last 3 years we have been doing this. This is hidden and unnoticed jewel in our crown, the housing finance business. This business we have started in 2018 and we have generated INR 1000 crores AUM with a good profitability and what is heartening is exceptional asset quality. The management team which we had given us this kind of a performance, made the board and the shareholders feel like this business instead of being a standalone should be made independent. We have recently promoted our business head to Deputy CEO position and we have capitalized this company substantially and also we are going to reconstitute the board and we are going to do everything which will make this independent in the next 6 months. This business is as you all know is going to be in six or seven states consisting of mostly South and West to states. It is going to be in self construction space. The ticket size is less than INR 10 lakhs, the yield is going to be around 14%. As the cost of funds is very low and the risk weight is less, we feel that this business will be more than 3% ROA business. With leverage it can produce a fantastic return on equity (ROE). The credit cost in this business as far as we are concerned is substantially low. We do feel that we will be able to grow this business from the current INR 1000 crores by 7X to 8X in the next 5 years, which is the kind of potential is there. This business will grow its separate independent branches and people.

The third balance sheet we are going to use is going to be the partnership bank balance sheets which is an off-balance sheet strategy we have developed for our SME as well as the new vehicle business. As we all know we have developed a business, a partnership with ICICI Bank, that will be strengthened going forward. The lower yield in SME as well as the new vehicle business will be done in partnership with bank.

With these three initiatives, we do feel that we have a fantastic growth story in the retail business from Q1 FY22. So, in commercial vehicle financing business, the used commercial vehicle and the other three products will be giving us a 17% to 18% yield. We have already touched in July

17.5% yield, so that would be further strengthened. With the cost of funds going down we have now 9.5 projected to be 9, we are going to be with the capital of about 25%, a double-digit net interest margin is going to be there.

With smart branches where the expansion of the branches operating expenses are going to be low and with the digitalization we do feel the operating expenses will be controlled and the productivity will be increased where we would be able to produce a very good return on asset in both these businesses. With off-balance sheet strategy the leverage is going to be fantastic. With these things with the kind of liability strength which we have done what we are looking at is no more further credit cost, the business teams are committing to us that the business which we will be doing most of them, more than 90% of them will be in Stage 1 necessitating a lesser credit provisioning. As we are carrying in the past 2 years a lot of provisions with write-off, we are also working on a micro level with each and every contract to enable and look at write-backs. The write-offs which we have done are mostly technical write-offs which are being done in the accounts and the balance sheet. But as far as the business is concerned the collection initiatives are continuing. So, we do expect that no further credit cost and there is a very good possibility of write-back. All our challenges and problems are behind us and we are looking forward to a 5-year of an exciting journey where we are making IndoStar as an emerging company with good businesses, granular, smart ticket, highly scalable, high potential and profitable. With the kind of infrastructure investment, smart branches and digitalization we do feel the operating expenses control and credit cost control we should be in a position to build a fantastic retail book.

A few words about corporate before I leave the forum for questions; the corporate book as I told you is running down and today; we have INR 1900 crores book. We have already taken a provision of INR 200 crores, the management overlays there which we have estimated could be eventual hair cut and run down this business. But we do feel that's more than adequate. I do feel that it is fully protected and covered but here also there is a possibility of some write-back as the borrowers who we have a long relationship, when they understand that we are not going to lag further. They are also shifting to other lenders where the balanced transfers are happening with haircuts literally, we are zero. We do expect that we have a cushion there. We are looking forward to a fantastic 5 years. The IndoStar is a growing organization in good business line. We have put the building blocks on both liabilities as well as on the asset side. As we are building our branches from 250 to 1000, you will find that our cost to income as well as the operating expenses moving up. But these all should not be viewed as expensive. These are all investments and as we are combining smart branches which are very cost effective with the digitization, the breakeven of these branches are made 50% time. Earlier it used to take 15-16 months. Now it's going to be 8 to 9 months. All these branches are going to pay back quickly and in the ramp-up period it is necessary for us to invest. That's why you will find that little cost to income but our income going up with good yields, we do expect that cost to income will come down to 30% in the next 5 years. That is a kind of information as preview I am giving to you.

As far as the Q1 is concerned, I would consider this to be a strong quarter for us considering the environment. We have made a disbursement of INR 628 crores during this month averaging to INR 210 crores in a month. In the CV business which is going to be the engine for growth, we have already started doing INR 230 crores which is nearly 1 crore per branch per month which is likely to go up to INR 300-350 crores. We are confident that every quarter we should be touching more than INR 1000 crores of disbursements. As I had mentioned the credit costs, we have been conservative in cleaning up, so we have taken credit cost as a proactive basis. So, all our credit costs are over. Now we are looking to build all these businesses going forward. With these views I leave the forum for an interaction. Me and my team would be very happy to answer all your questions. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, we will now begin for the question-and-answer session. The first question is in line of Dixit Doshi from White Stone Financial Advisors.

Dixit Doshi: My first question is related to the prepayment and the balance transfers. If I look at, we have done INR 627 crores of disbursement and our retail book has come down quarter-on-quarter by almost INR 520 crores. So, the prepayment or balance transfer is almost (+1,100). We are targeting INR 1000 crores disbursement every quarter then what gives you confidence of adding INR 3000 to 4000 crores book which you used to tell in the last quarter.

R. Sridhar: In the past there are two things, one is the runoff of our existing book and as our disbursements grow beyond the runoff there will be a positive accretion. So that has started already happening. The second one is in this quarter we have also sold their portfolio. That is why you will find that the retail portfolio has come down. That's all over now. So, from now on there will be a positive increase to our assets. So, as I'd mentioned to you, we are confident of growing the disbursements in retail only of beyond INR 1000 crores in this quarter itself. So, from this quarter that will be a growth month-on-month and quarter-on-quarter in the three retail businesses which we are focusing, particularly vehicle will be the engine, then affordable and SME. In all these three businesses if you take three quarters we should be (+3000). That is what I've mentioned.

Dixit Doshi: And can you just elaborate on that how much would be the monthly or quarterly run rate of rundown of the book, prepayment or balance transfer?

R. Sridhar: Should be slightly less than INR 200 crores.

Dixit Doshi: Quarterly?

R. Sridhar: Monthly.

Dixit Doshi: Now the second question is, what will be the annual size of the used CV market and related to that you mentioned that scrappage policy will benefit. But just a question related to that, let's say if somebody have a 15-year-old vehicle and he go for a scrappage, he will be getting in some of the incentives like the registration cost will not be there for a new vehicle purchase, then why he would go for the used CV the other than a new purchase?

R. Sridhar: Basically, we are going to focus on 5 to 12-year-old segment which in an 8-year model, the current estimate is around 7 to 8 million vehicles are there in the population, where Shriram Transport and Chola are the major players and few peripheral players were there. Their penetration is less than 50% if you look at their assets under management. So, the balance is contributed by the unorganized sector. There are no other serious players in this segment. That is why because of my background in used commercial vehicles finance business for three decades we are getting into that space sensing a great opportunity. The base itself gives you a fantastic opportunity to gain market share from unorganized sector. Plus, as I mentioned the 15-year-old vehicle are 7 to 8 lakhs. These vehicles are anywhere between 15 to 25 or 30. These vehicles application we have to understand. These application for small distance freight carrying activity. It could be in the construction sites carrying sand and bricks. It could be garbage cleaning in municipal corporations. It could be in household shifting. But it would do a very short distance freight carrying because of the age and inefficiency. So when the government brings too many restrictions and constraints in operating this business, these people would like to change their vehicle but they cannot go for a new vehicle because the price differential will be huge which will not support their freight earning. So, they will go for newer vehicle. So, when they go for example 10-year-old vehicle, the person who sold the 10-year-old will go for a 5-year-old, a guy who sold for 5 years will go for a new vehicle. That's the thought process. So, every vehicle, basis more than 15 years if it has to become a new vehicle demand it has to churn three times minimum. That is why we feel 8 lakh vehicles if it has to phase out will have to create 24 lakh of replacement demand. If we take an average of 5 lakh under the INR 20,000 crores will be the replacement demand. That is what I mentioned. This 15-year-old is not going to be a static one. Every year there will be one-year vehicle will become for 15-year-old. So, it's going to be a continuous replacement demand which will come. If this becomes successful, I'm very confident the government will bring down 15 to 12 years. Then that 12 will become 10 years. The end-of-life policy in the next 10 or 15 years will become 10 years is what I suppose. For the benefit of this country, better fuel efficiency, better road maintenance, all that will be helping if we modernize the fleet. The used vehicle replacement demand is going to be continuous for next decade or two. So, sensing an opportunity we are getting into that space in a very aggressive manner with an aspirational growth plan. This is very profitable, highly scalable and we have put together a team which had 20 to 25 years of experience in building this business.

Dixit Doshi: Just one last question from my side, what is the deadline for promoter to bring down the stake to 75%, by when they have to bring it down?

R. Sridhar: Today because of the pandemic there is no hard and fast rule here. But the shareholders are working on it and they will do in consultation with the regulators.

Dixit Doshi: Is there any deadline from regulator that by this time?

R. Sridhar: No, regulation is different but considering the pandemic, the regulation is flexible.

Moderator: The next question is from the line of Rishikesh Oza from Robo Capital.

Rishikesh Oza: My first question is that, you have talked in the last con-calls and also in this con-call about multifold loan book growth, around 7X-8X. Also, you have talked just about 1000 crores of disbursement, so if there is no third wave can we expect this at least 40% annual growth run-rate to start from next one or two quarters loan book side

R. Sridhar: As the base is low, the growth percentage will be very high. We are INR 6000 crores retail book now. So that INR 6000 crores in one year if we are doing a INR 4500 crores of disbursement, there will be a disbursement growth to the base is 75%. But if you deduct the runoff, we will be growing around 30% to 35%.

Rishikesh Oza: My second question is, what will it be the credit cost for FY22 and FY23?

R. Sridhar: Our credit cost is completely provided and protected as I told you. There will be no further credit costs from retail business as well as corporate business for the existing portfolio which was there as of 31st October, 2020. So that is one batch of assets we are keeping. The second batch is businesses which we have disbursed from November 1st, 2020. As I mentioned that will continue to be most of the portfolio in the more than 95% will be in Stage 1. There will be a very less incremental provision which would be required. As we are also hoping that there will be possibilities of write-back that the net of the write-back and the incremental provision will be positive to the P&L.

Rishikesh Oza: So, our yields are between Chola and Shriram Transport, so will it be fair to say the normalized credit cost in future years will be between the credit cost for those two players which comes to around 1.5 % to 1.75%?

R. Sridhar: I will tell you a benchmark that Shriram is operating at more than 20%. So, 24% so their credit cost is higher because they are operating in a slightly riskier segment and Chola is at 14% blended yield. Where their used vehicles were around 15%, new vehicles are around 12%-12.5% so they are operating at 14%. So, we are adopting a different strategy. We will be operating on a balance sheet completely used which will between 17% to 18%. The yield of IndoStar is going to be between Chola and Shriram as you rightly said but it is going to be fully used vehicles. And the new vehicles will be in bank's balance sheet. So, we do hope that our blend will be around 16%. If you take an industry benchmark of over last few decades, it would be 10% of the yield, could be the maximum credit loss. You are right in putting a 1.5% to 1.6% as the eternal credit cost in our CV book going forward.

Moderator: The next question is from the line of Abhijeet from Kotak Securities.

Abhijeet: The first question was around your asset quality. If you could please kind of help us understand what is your Stage 2 looking like now? And if possible if you could, if a product wise Stage 2 for the three retail product segments?

Amol Joshi: One is as we have alluded in Q4, our Stage 2 at that point of time was 24.5%. We have seen a slight improvement there with focus at our side clearly being on containing Stage 1 and Stage 2 movements and also, with the new collections head at the helm, we clearly see traction and it's only become better as of July. Between the products the key movement between Q4 and Q1 has been on the SME book where we have seen some incremental stress where there's a Stage 1 to Stage 2 movement and also, some restructuring that we have done. As I have mentioned in our previous calls any restructuring that we do even for the zero DPD customer we by default classify that customer as a Stage 2 customer and break incremental provision. The RBI has also while we have been doing a 10% provision on all restructuring, the RBI also recognize the fact that it needed incremental provision and they have up their limit from 5% to 10%. We have also taken a recognition of that fact and where required on a case-by-case basis even though it's a granular retail portfolio we have stepped the provision accordingly. While overall basis, it has moved into a better terrain, from an SME perspective there's been some incremental movement from Stage 1 to Stage 2.

R. Sridhar: And going forward we do expect that we should come to a single-digit Stage 2 by March 2022.

Abhijeet: When you say it will come down to single-digit Stage 2 and Amol was alluding that from 24.5% in Q4 it has come down marginally. So fair to say that maybe let's say if we are at around 20%-to-23%-mark Stage 2, by when do you expect this to come down to single-digit Stage 2

R. Sridhar: See there are a couple of strategies we are adopting. One is as I said told you October 2020 that book, we are building a separate collection vertical and we are doing everything to collect and roll back their stages, 3 to 2 and 2 to 1. That's a big focus with that we are doing. Also, the book which we are generating now, new book as I told you in the nine-months more than 95% is in Stage 1. We will continue that kind of incremental book which will also help us in improving the blended books stages. That is why we feel that it should move to a single-digit by March '22 as we put another INR 3000-4000 crores of book which exceptional asset quality.

Abhijeet: Amol you alluded that there has been some movement from Stage 1 to Stage 2 in your CV book. I recall last quarter we had suggested that the CV Stage 2 was around 32%. Would it typically be around the 34%-35% mark now?

Amol Joshi: Yes, it is holding, it's actually a few percentage points better but it's in the same range.

Abhijeet: Any indication on what is the kind of provisioning that we are carrying in the different product segments CV, SME and affordable housing?

Amol Joshi: So, clearly in Q4 we did a step up in provisioning especially on Stage 3. You can see that in the asset quality slide that we have put in, we are at 55% and there about for CV and SME also we have increased date, for HFC we are at around 20%. What we have clearly seen is that these provisions as we start recovery process and things normalize on the ground, we expect as we revisit the ECL model in the coming quarters to get a bit toned up because when we did it, we had the advantage that we did it in the mid of June where wave 2 was at its peak. And hence the whole environment supported that kind of provisioning. As we go through the year and things normalize, we will see some tone down in the overall provisioning rates, we are carrying at every stage of our book.

Abhijeet: The other question that I had was on the restructuring. Obviously on a q-o-q basis we see that the absolute amount of restructured pool has come down but important thing for us and maybe the other investors is to understand that what is the pipeline looking like for you? Because I mean like you know this restructuring window is open until September end. So, I mean what are the thoughts around where could this restructuring pool finally settle depending on what the pipeline is looking like now?

Amol Joshi: Thank you for the question. It gives me an opportunity to explain it in detail. Clearly, you would have seen that for our affordable home finance business, we had done zero restructuring. Restructuring for us as a tool is an opportunity only if the customer needs it. Our team actually assesses the requirements. Lot of times what we have seen some of the other lenders to that our customers have allowed them restructuring. So, they treat it as a right. Whereas when we see capacity to pay, we hold on with an option from our customers at least. That kind of conflict happens on the ground but clearly as we moved beyond the wave 2 in July, we have seen the traction for restructuring coming down. There will always be pockets where we might eventually take a call between now and 30th September but we don't see any major upswing in the kind of volumes we are looking for restructuring.

Abhijeet: The other two questions that I had was for Sridhar sir, one was on growth, the other one was on OPEX. While you have obviously briefly touched upon them in few of the previous questions but where we are now and assuming that I mean the COVID-19 is here to stay for maybe the next few quarters and we really can't kind of predict how the COVID-19 situation in the country will be like. But that thing aside I mean for the next let's say 4 or 5 years where do you see yourself growing to over the next 4 or 5 years and the other thing is around the OPEX. I mean you did talk about opening smart branches which will have about half the breakeven time. You did talk about that hub-and-spoke model. But having said that I mean where do you see this OPEX finally kind of settling down after let's say the next 3 to 4 years?

R. Sridhar: See as I told you the OPEX today is looking little high because of some one-off costs are there. So, if you net it off, they should be around INR 25 crores for this quarter which would grow a little bit on quarter-on-quarter basis due to the infrastructure which we are creating. As and when we grow our branches, there will be an operating expense which will come. So, as I mentioned to you that if you looked at as an investment for future growth because without branches, we will not be able to grow our book. Having said that, we are also focusing on reducing the operating expenses substantially. We are going for low-cost, less space branches which will have very less fixed cost. Plus, we are combining with a state-of-the-art digitization, an app which will be given to the build staff for doing most of their activities. With that we would be able to reduce the operating expenses substantially and the enhance the productivity of the field force. That would be reflected in the breakeven which we would measure in terms of that. So that is the point. This quarter it has been inflated to the extent of around INR 20 crores which had been one-off cost which should be neutralized. With regard to your growth, I have already mentioned to you that in the vehicle finance, used vehicles I feel that from the current levels of 3200 or something like that we can look at 10X in 5 years' time. As well as in the new commercial vehicles which would be at 25% of that book. In affordable housing I am putting from 1000 and 7X to 8X but if you are confident of the asset quality, we can even look at 10X there. The potential for growth is fantastic in our space. As you notice that these businesses are niche businesses where we are having lot of entry barriers. Not new players are going to come into this space in a big way. The potential is very high, profitability is good and the scalability is outstanding. If we have the right kind of teams which can source and underwrite and collect then we should be in for a fantastic 5-year growth plan.

Moderator: The next question is from the line of Pankaj Prasun from HNI Investor.

Pankaj Prasun: My question is very strategic in nature. I want to understand that last four-five quarters you are doing there as far as provisioning and all. Can you assure us as an investor that from here on there will be no such kind of bombarding on us, the first thing is that? And what I understand due to this scrappage policy and the pent-up demand, the kind of China Plus one activity is going to come to India. The demand for commercial vehicles will be very large. What I understand from the IndoStar team is having collectively they had managed more than INR 1.5 lakh crores of assets either Sridhar sir or Deep Jaggi sir or Mr. Ravi or Mr. Sudip or Jaya Janardhana collectively. So, Sridhar sir, we are right from what you were telling 5-year you are targeting something like INR 40,000 crores. Don't you think that the kind of team you have, you have a great potential to these to more than INR 1 lakh crores so those things I want to understand.

R. Sridhar: Thank you. So, you see what we normally do is put together a plan and execute it. So, you are absolutely right in my past also when I looked at three times growth, I had grown seven times-eight times. As you rightly said, if we have the building blocks of liabilities strength that we have Brookfield as our partner, that is a big bucket. If there is an opportunity to grow more capital is not a constraint. Today NBFCs apart from the asset side strength should have the liability side strength also. As I have articulated a partner like Brookfield plus a strong ALM and a liquidity pipeline and another strategic partnership with ICICI puts IndoStar in a different league. With the kind of product which we are going to be present in a granular ticket size which is scalable with high potential in the next 5 to 10 years, we are a different kind of a NBFC which is going to take advantage of the unfolding potential which is going to come post the pandemic.

As you rightly said the combined assets under management which me, Deep and Ravi and other team members have done is in excess of INR 100-1000 crores or something like that. There are not many players who are going to come into used commercial vehicles. We are going to be the third largest player and because of lower size, our ability to grow and we are going to be nimble. So, as you rightly said we are putting a number and for the direction but if there is an opportunity, nothing puts us in a constraint to grow beyond what I have mentioned.

Pankaj Prasun: My one question was that can you show us henceforth there will not be any negative surprise on the provisioning front?

R. Sridhar: Yes, I am assuring you.

Pankaj Prasun: What I understand Brookfield has got a very good name. This is the only NBFC, MNC-NBFC which is trading at a such a steep discount. Somewhere we are not able to convince the investor that now onwards we are not going to give you SA?

R. Sridhar: See it's not only on the credit cost. We are doing a transition. During the transition unfortunately we encountered multiple challenges. And because of that all these things have happened. As I mentioned to you all these are over and now, we should march forward with corporate lending going down, retail business going up, credit costs have been taken, write back possibility. I am sure that the market will recognize. The other one is the affordable housing finance business which have not been factored by the market will also see traction. I am very confident that this will be noticed and as we show month-on-month and quarter-on-quarter progress in our performance the market will recognize. That will happen from now so I am assuring you that.

Pankaj Prasun: One more thing. Do we see that we will be a flavor of Fintech also in IndoStar?

R. Sridhar: Yes. Our business is involved an asset which needs to be done. We are building a very state-of-the-art digitization. We will also bring in Fintech partners to help us in customer evaluation, in risk of management in fraud control. So many things which we are talking to the different players. We will bring that one once our digitization is ready in the next couple of months.

Pankaj Prasun: I would request you to kindly incorporate those things in next investor presentation please.

R. Sridhar: Thanks for the suggestion. We have taken your point and we will incorporate it.

Pankaj Prasun: One more thing on the ESOP front in the past I have seen the big authority from the company has used this like a day-to-day expenses kind of. Please be mindful because our equity is very costly, IndoStar equity is not so cheap. In the past it has happened and that has hurt me a lot.

R. Sridhar: We take your point. Now the team which had the initial ESOP has all left. Now whatever we are giving is a rear ended so it's a 10-20-30-40. The team has been clearly told that it is a retention policy, as we are emerging there is we are going to do an ESOP now which would be top-down for about 150-200 people only. It won't be a challenge in the future.

Pankaj Prasun: Thank you sir because I see IndoStar in a at least in 6-digit market cap.

Moderator: The next question is from the line of Pracheel Shah from Capgrow Capital.

Pracheel Shah: Just coming to know about a data keeping question. So, slide #19 you have shown the GNPA and net NPA for the firm. Does this include the standard provisions as well in excess of NPA?

Amol Joshi: This is only the Stage 3 that we have put it out here.

Pracheel Shah: What is the excess that they are carrying on the books?

Amol Joshi: What happens is that the provision pool if you typically tag it against the individual asset. Just to give you some flavor around of our 7800 crores of AUM we are carrying around 8.8% of provision cover between Stage 1-Stage 2 and Stage 3. On slide #19 what do you see is only the Stage 3 book.

Pracheel Shah: 8.8% of the book you are carrying you said.

Amol Joshi: Yes, correct.

Pracheel Shah: Just wanted to know about the growth that already previous participants have asked. So what challenges are we facing today when we go out to disburse? What is stopping us from disbursing? Because if you see your competitors Shriram and Chola, they still have grown their book year-on-year in the past few quarters. Whereas we have rundown our book to the previous six quarters and even beyond that so what challenges are we facing? What is stopping us from growing our book especially when we have so much capital sitting on our books?

R. Sridhar: From last March '20 when the COVID and lockdown started, everybody stopped disbursing but some companies which are old have still continued but we stopped and we made it a policy that as and when we collect 100% collection then we will restart. Slowly the collection efficiency improved which we have given in our table. October 2020, we achieved 100% and we started disbursement from November. If you are comparing the disbursement numbers between IndoStar, Shriram and Chola; if you see the branch average everything will be more or less same. Shriram has got about 2000 branches positioned so they do easily 2000 crores. They can do even still more. This business is having a constraint of about 1 crores or 1.5 crores one will be the productivity of a bank, in a simple product. As and when we ramp our infrastructure, branch network, our disbursements will grow. Today there is no comparison, 250 branches we are doing 250 crores.

Pracheel Shah: You said so as and when you open new branches, growth should come in, is that correct?

R. Sridhar: Yes. See for example as I told you today 250 branches are 50 hubs these 50 hubs have got a hub location plus three branches one rural center, six which will do five locations which will do about 6 crores disbursements minimum. For our 50 hubs we should do 300 crores which we will reach this month or next month. When we do that as and when we keep increasing our hubs, our disbursements will grow. For example, in 2026 when we are going to have 200 hubs which are inflation of 25%, we should be doing a 1000-500 crores disbursement per month is an estimate.

Pracheel Shah: So, with these hubs rising and the number of branches also rising; how do you see efficiency kick in because we are also biding for a drop in cost to income. Are you saying that these branches are not, they are very low-cost model or how does that work?

R. Sridhar: Yes, I have explained low-cost branches, we call it smart branch combined with the digitization app and all that. We are reducing the operating expenses which we are incurring a more in the Gen-1 branch, now this Gen-2 branches will be low cost and then productivity will be increasing as against the 25 lakhs productivity the field officers will be doing 25 lakhs so because of that the breakeven will come down from 15-16 to 7-8 months. That is the efficiency which will keep and as I have told you in order to sustain the asset quality, we are also building a collection vertical. We have brought in a guy who had spent 11 years in Chola as our National Collection Head for CV and with that we are building a collection vertical. From the portfolio which we are generating from November, we are trying to keep more than 95% in this Stage 1 all the time so that we are monitoring very closely. And when we do, that the asset quality will get sustained. With operating expenses reduction, productivity increase and with efficient credit management, we would be able to increase the return on assets substantially because we are operating in a higher yielding product, cost of funds is going down. All these things are going to work for us. So, the strategy is in place. We have to go on executing.

Pracheel Shah: One last question, you said that Stage 2 in the previous quarter was 24% and 24.5%. This quarter it is a little lower than that. How does that compare to pre-COVID scenario?

Amol Joshi: Clearly before pre COVID we had a few challenges in growing the book. It used to hover around 12% to 15%. Our going forward outlook that we have is as Sridhar alluded to bring it down to single-digit as we embark on our journey to really expand retail disbursements.

Pracheel Shah: So roughly around 8%, I can assume that 7-8 percentage points we are higher than pre-COVID right now in Stage 2?

Amol Joshi: Yes, you are right. The external environment is such that I think it will only get better from here.

Pracheel Shah: Most of it would be sitting in CV?

Amol Joshi: CV is my largest retail book, you're right. Most of it is in CV.

Moderator: The next question is from the line of from Alpesh Mehta.

Alpesh Mehta: One is after entire execution of the story in your 3-year or a 5-year plan where do your ROAs and ROEs settling down. That's the first part. Secondly, from a near-term perspective we are still sitting on a very high amount of liquidity which would be one of the highest in the system at almost 23%-24% of the borrowings. So, what is the plan to run down this excess liquidity from the balance sheet consulting the environment now and two questions for Amol as well. All these restructured loans I assume they should be a part of the GS 2 loans and is there any pipeline left or the requests that we have next 3 quarters? And another question on the corporate loan, are we done with all the kind of provisioning which is required on the corporate loan? So, any termination losses or the mark-to-market losses when we sell down the portfolio?

R. Sridhar: As I had articulated Alpesh the ROA will keep increasing, the incremental book which we are improving is in a double-digit NIM. With the credit cost behind us which we have an aspiration to have an ROA of more than 3% in both the businesses but the credit rating mandated leverages five times. What we are trying to do is there are 3%-3.5% ROA will get to a 15% ROE but what we are doing as a strategy to enhance the return for the stakeholder, we are also combining a strategy of off-balance sheet in the businesses of new vehicles and SME. That would require a lower capital so we can leverage around six times. I do foresee in the next 5 years we should be on a gradual increase from now, should be in the band between 15% to 18% is what is our projections show which we should definitely be able to achieve it if our executions are in place so that is what we are doing. As far as the liquidity is concerned, we are making conscious efforts to reduce it. Because of the environment the rating agencies have requested us, mandated us to carry a larger cash. As things improve the cash is being reduced and we are also making a little bit of improvement in the treasury income. Plus, the cost of funds is continuously on the decline. From a double digit we have now come to 9.5 we project it to be 9 by March '22 and still if the benign interest rate regime continues, we should be marking this average cost. So marginal cost is lower, average cost is coming down. I do feel that in next 1 or 2 years if this trend continues there will be a convergence of the average and the marginal cost to below 9% which is going to enhance our net interest margin substantially. All sides we are making progress and the results will be visible in the quarters going forward.

Alpesh Mehta: Just a slightly on this point on the incremental, since our incremental cost is or fund is around 8.4%, right? And the lending that you are doing is at around 16% on the CV loans. So almost 7.5% kind of a spread and the (+10%) kind of a margin are we doing for the incremental book although we do CV segment right now?

R. Sridhar: As you rightly said we will be in a double-digit net interest margin in the used vehicle all the time. Even if you assume that in the next 3-4 years the capital adequacy comes down to 20% even then, 8% spread will give you a 10% NIM because you are adding **80% 1.00** capital to it. If you look at our affordable housing, we have a (+40%) capital adequacy then. There with a spread of 6%, there also we will be near to a double-digit net interest margin. All these things will be visible once the existing book and the growth comes in, a control. So, we are attending to it. By March '22 we will look totally different with another INR 3000-4000 crores we put it into the retail of good quality, everything will look different. That would be a foundation on which we would like to grow next 4 years.

Alpesh Mehta: The existing book which is sourced pre-October '20. Is it fair to assume that by mid of next year the entire book would be repaid, the retail loans?

R. Sridhar: Most of them will run off, particularly the acquired book will go off by middle of next year and some restructured books have been elongated repayment schedule so that will continue. But what happens is that the control on the credit cost has already been taken. There will be no more negative surprises in that portfolio. So, it will run off so the new book which we are developing is micro-managed on a day-to-day basis. Deep Jaggi takes control of the situation and monitors it on a daily basis. We don't allow any slippages there. Any remedy is attended to immediately then and there. We would like it to be culture of the company and then on top of it we are also building a collection vertical. Everyone is going to be pre-occupied and obsessed with the asset quality and we will be focusing on that. The existing book when it runs up you will have a much superior quality portfolio in both our businesses.

Amol Joshi: On restructuring clearly, our window is another 1.5 months and you have seen the numbers, we did in Q1 which were during COVID. As things normalize, we will actively work with our customers to ensure we don't opt for this especially if we see that if it's only a short-term blip. Where required will still exercise the call to do the restructuring. Affordable home as you seen we have managed to hold good; it has led to increase of some NPAs but quite confident that as we proceed to August and September some restructuring will happen there which will not be in excess of around 2% or 3% of the overall book. In terms of your question on corporate book the 200 crores provision that we carry, we feel is sufficient to take any shocks as they come. Some traction on sell down is already happening. Hopefully even we give Q2 numbers we will have some concrete numbers to share with you on the same.

Alpesh Mehta: Thanks. I guess we are run out of the time. Thanks a lot. Do you have any closing comments?

R. Sridhar: No, as I have mentioned that I had a detailed given an overview of what is that we are planning to do in the next to 5 years. We have to come out of the hangover of the past, that's over and we have control on everything, we have put the building blocks in place. The team is very confident and bullish about the execution of that which you will all see on a month-on-month and quarter-on-quarter, the improvement in the space. We are going to have an exciting 5-year journey and we do hope that there are no environmental shocks which will come. On that basis we have built it and whatever I have articulated we are confident of achieving it and we will only improve, as I said no credit costs and there are possibilities of right back, growth is absolutely in place. With these words I would look forward to meeting you again in the next investor call and wish you all again safety and health for you and your family. Thanks for joining us and look forward to meeting you again. Thank you.

Alpesh Mehta: Thanks a lot everyone for joining us for this call and thanks a lot to the management for allowing us to host this call. Thank you.

Salil Bawa: Thank you very much. If you have any further questions, please feel free to reach any one of us.

Moderator: Thank you. Ladies and gentlemen on behalf of Motilal Oswal Financial Services that concludes this conference call. We thank you for joining us and you may now disconnect your lines. Thank you.